MEMORANDUM

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U.S. Securities and Exchange Commission

FROM: Steven W. Stone
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DATE: October 19, 2010

SUBJECT: Form ADV Amendments -- Timing Concerns and Interpretive Questions

Thank you for taking the time to speak to us last month about the concerns expressed by many Securities Industry and Financial Markets Association ("SIFMA") members on the recently amended Form ADV, particularly the brochure supplement on Part 2B. As we discussed, the more that firms, particularly large ones, have embarked on in-depth planning for the transition to the new forms, the more these firms have grown increasingly apprehensive about their realistic ability to meet the March 31, 2011 deadline for initial distribution of brochure supplements. Since we last spoke, we have had numerous discussions with members of a working group comprising some of the largest SIFMA members that are registered investment advisers, in an effort to gather their perspectives on the transition process and challenges, including their interpretive questions on the brochure and the brochure supplement.

The purpose of this memorandum is two-fold: First, we seek to provide the staff with a deeper understanding of the many significant logistical challenges firms are confronting as they seek to meet the initial March 31, 2011 deadline for distribution of brochure supplements in a reliable way so that we may explore appropriate relief extending the compliance dates for distribution to existing and new clients to December 31, 2011. Second, we would like to outline to the staff the 26 interpretive questions that the members of the SIFMA working group have identified, the answers to many of which will be important as firms' planning processes proceed. We address each of these points in turn below.

I. Timing of Brochure Supplement Preparation and Delivery

The approaching March 31, 2011 deadline represents a potentially insurmountable hurdle for the largest investment advisers (mostly all dual registrants) seeking to meet the March 31, 2011 deadline. We realize that it might seem too early to seek relief, and the December 31, 2011 extension might seem too generous given the SEC's analysis when adopting the new forms. Accordingly, SIFMA assembled a working group of 12 firms including many (but not all) of SIFMA's largest members to elicit information on relevant aspects of their business and the challenges they have identified to date when planning for the transition.

To understand the magnitude of the transition (particularly for the largest firms on which the burdens will be disproportionately greatest), one needs to start by looking at the numbers involved. Attached as Exhibit 1 is a compilation of important metrics affecting the ability of large firms to meet the current brochure delivery deadlines. This compilation reflects survey data from the 12 firms in the SIFMA working group (including firms with as few as 400 financial professionals and as many as 17,000 financial professionals) and the averages for the largest five firms (again, for which the burdens will be disproportionately greatest). As reflected on the exhibit, collectively, these 12 firms alone provide investment advice to over 6 million investment advisory clients, who represent over 20% of total clients advised by U.S. registered investment advisers.[1] These accounts are serviced by more than 65,000 supervised persons for whom brochure supplements are anticipated to be required, who work in roughly 39,000 teams or partnerships and are supervised by over 7,000 individual supervisors. These firms open close to 5,000 advisory accounts on a daily basis.

Beyond the sheer numbers involved, the very process of creating brochure supplements for the largest firms involves 13 or more distinct steps that generally will need to occur in a sequential manner. These steps are depicted on the diagram titled, "Process for Rolling out Brochure Supplements," attached as Exhibit 2. Many of these steps are formidable in their own right, but collectively they pose a potentially insurmountable hurdle given the delivery deadlines. Below we highlight a few of the concerns.

First, the brochure supplement calls for many items of information that firms may not currently maintain, have ready access to or verify on a regular basis such that the information could simply be "plugged" into the new brochure supplements. This includes information on supervised persons' educational backgrounds, professional designations, nonreportable disciplinary events, compensation and supervision. This information will have to be obtained from or for each affected investment professional, reconciled, verified and compiled into the new brochure supplements.

Second, the systems to collect and compile the numerous items of required information into one document (the brochure supplement), and deliver the brochure supplement to the client when events require, do not exist today. New systems will have to be designed, built and tested that can compile all the various items of information from various sources, including the 84 separate systems reported in the survey data (or, on average for the largest five firms, 11 systems per firm). All told, the five working group member firms that were able to come up with estimates indicated that the man hours needed to develop technology to automate the data collection and compilation process will at total over 50,000 hours in the aggregate for those firms (an average of roughly 16,000 man hours per firm responding). Moreover, the process of designing, building and testing these systems will be forestalled or interrupted by "technology freezes" that for most large firms will roll into effect from mid-December 2010 to mid-January 2011. Attached as Exhibit 3 is a chart that graphically displays the technology freeze dates in relation to the firms employing the greatest number of investment professionals giving investment advice.

Third, most supervised persons at mid- to large-sized firms are also FINRA-licensed registered representatives. Accordingly, the brochure supplements for these persons would likely be

[1] *See* Investment Adviser Association, Evolution/Revolution, a Profile of the Investment Adviser Profession (September 28, 2010), at 9 (stating based on SEC data that there are 30 million investment advisory clients in the US in 2010).

considered marketing material subject to FINRA Rule 2210(b) and would need to be reviewed and approved by a registered principal, causing further delay before the brochure supplements could be used for new clients or sent to existing clients. Advisory firms with robust supervisory controls would be compelled to require similar approval before use.

Fourth, the information to be reported in brochure supplements is far from static. The preparation of brochure supplements is complicated by turnover among investment professionals (which firms expect to peak shortly after the 2010 year end) and changes in investment professional teams that service client accounts and the designations of supervisors responsible for supervising the investment professionals.

For these reasons, we would like to discuss appropriate relief that would extend the compliance dates for distribution of brochure supplements to existing and new clients to December 31, 2011 so that firms can ensure that brochure supplements are accurate and delivery issues can be addressed.

II. Interpretive Questions on the Brochure Supplement

As noted at the outset, members of the SIFMA working group have identified an array of interpretive questions relating to the new brochure and brochure supplement requirements. These are presented below, grouped by category of question.

A. Covered Supervised Persons

1. Does Rule 204-3 require that clients in separately managed account (or wrap fee) programs who hire an investment manager on the recommendation of their investment professional receive a brochure supplement for the investment professional as well as a brochure supplement for the separately managed account manager's investment team? Providing the brochure supplement for the investment professional in this instance provides little value, and may be confusing to clients, as the investment professional does not have discretion over the client's assets and does not recommend or select specific securities.

2. Does Rule 204-3 require that a brochure supplement be delivered for branch office managers, product specialists or business-area heads (for example, a Head of Manager Research) who may meet with high-net-worth clients from time to time to explain firm capabilities and offerings but who do not provide specific investment advice to clients or exercise investment discretion over their accounts? The client's investment professional is usually present at the meetings and is responsible for providing the advice to the client. Please clarify that the brochure supplement requirement is not triggered ***by mere client contact*** and that it does not apply in instances in which the particular supervised person is not providing investment advice to the client with whom they are meeting.

3. Would a supervised person, including one associated with an investment adviser that is also registered as a broker-dealer, exercise investment

discretion for purposes of the brochure supplement delivery requirement if he or she does so only on a temporary or limited basis?

4. If a supervised person formulates investment advice and has direct client dealings on a temporary or limited basis (e.g., covering for the supervised person primarily responsible or participating on a limited basis on limited aspects of the advice, is that supervised person's brochure supplement required to be delivered to clients? Similarly, if a supervised person formulates investment advice, but only has direct client contact telephonically through a call center or toll-free telephone number where a client may reach any supervised person who answers the phone, is that supervised person's brochure supplement required to be delivered to clients?

5. When a person acts as a solicitor for an investment adviser, does that person "formulate investment advice" such that the solicitor must deliver its brochure supplement to the prospect (in addition to the solicitor disclosure document under Rule 206(4)-3 and the investment adviser's Form ADV Part II)?

6. If a supervised person merely enters client information into a "black box" database or investment questionnaire that produces an asset allocation or list of securities selected for the client, and the supervised person cannot alter the asset allocation or securities selection, does the supervised person "formulate" investment advice for purposes of brochure supplement delivery requirements?

7. If a supervised person assists a client in choosing among several investment advisers or mutual funds provided by a "black box" database or investment questionnaire, and the supervised person cannot suggest alternative advisers or funds, is the supervised person "formulating" investment advice for purposes of brochure supplement delivery requirements?

8. Please confirm that the exception under Rule 204-3(b)(3) that addresses investment advice that is provided by a team comprised of more than five supervised persons applies to supervised persons that make discretionary investment decisions, as well as those that formulate investment advice and have direct client contact. The note to instruction 1 to Part 2B seems inconsistent with Rule 204-3(b)(3) in that the note contemplates that the five person exception applies only in the case of supervised persons who have discretionary authority over client assets.

B. Delivery of the Brochure and Brochure Supplement

1. Rule 204-3 requires delivery of the brochure before or at the time "you enter into an investment advisory contract with the client." Please clarify

that sending the brochure once the advisory agreement is effective and accepted by the adviser complies with the Rule.

2. Please confirm that delivery of the brochure (or any summary of material terms) or amendment thereto may be made on a householding basis such that individuals who live in the same household and who have authorized the firm to combine mailings on their accounts may receive only one copy of the brochure, summary of material changes and brochure supplement.

3. Clients may establish advisory accounts with the same investment professional over a period of time. Please confirm that delivery of the brochure supplement to a client with the establishment of their first account complies with the rule's delivery requirements so that clients do not need to receive multiple brochure supplements for multiple accounts so long as the brochure supplement has not been amended and there has not been a change in the supervised person's disciplinary history.

4. Rule 204-3 requires the brochure supplement to be provided "before or at the time that supervised person begins to provide advisory services to the client." Please confirm that delivery of the brochure supplement upon effectiveness of the advisory agreement is acceptable (*i.e.*, that the notion of providing advisory services contemplates such services being provided under the advisory agreement).

5. When a brochure supplement has to be delivered due to a material event, what is considered a reasonable period of time in which to deliver the supplement to clients?

C. Duplicative Burdens

1. If all supervised persons in an advisory program are compensated on the same schedule (Item 5) and the supervision and advice monitoring systems for all supervised persons are the same (part of Item 6), and those Items are disclosed in the firm brochure, may the investment adviser refer, in the brochure supplements, to its firm brochure, rather than repeat that same information in each brochure supplement, which would increase the length and cost of the supplements?

D. New or Substitute Supervised Persons Brochure Supplement

1. If a supervised person for a client's account leaves and is replaced by another supervised person, what is a reasonable time in which to send the new supervised person's brochure supplement to the client?

2. If a supervised person is only handling an account for a temporary time, such as when the primary supervised person is on medical leave, is the investment adviser required to send clients a brochure supplement for the substitute supervised person?

E. Professional Designations – Item 2

1. Item 2 permits the listing of professional designations so long as they are accompanied by a "sufficient explanation of the minimum qualifications required for each designation to allow clients to understand the value of the designation." May a firm include a brief explanation and refer the client to the organization or its website where they may find additional information on the qualifications and other characteristics of the designation? May a firm rely on prototype disclosure from a professional organization for this purpose so long as the firm does not believe that such information is incorrect?

F. Disciplinary Events – Item 3

1. Item 3 requires disclosure of any "other proceeding" in which a "professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct." However, the term "proceeding" is defined primarily to relate to certain enumerated disciplinary events brought by governmental or regulatory authorities (not a good fit for professional designations). Would Item 3 thus cover revocations or suspensions of licenses by such organizations as FPA, NAPFA or IMCA?

2. For clients who have not agreed to electronic delivery, is delivery of the BrokerCheck report acceptable to satisfy delivery requirements relating to disciplinary events?

G. Other Business Activities – Item 4

1. Item 4 requires that a brochure supplement disclose if a supervised person has an application pending to register as a broker-dealer, registered representative of a broker-dealer, FCM, CPO, CTA or an associated person thereof. Employing investment advisory firms may not become aware of this information in the case of departing employees because the supervised person may hide this fact. Accordingly, does this disclosure requirement apply to an investment advisory firm only where the firm knows or should have reason to know of such a pending application?

H. Additional Compensation – Item 5

1. Item 5 requires disclosure of "economic benefits" received. Please confirm that Item 5 excludes the receipt of gifts and entertainment, which would be subject to the restrictions imposed by each firm's internal policies and procedures.

III. Interpretive Questions on Brochure: Methods of Analysis, Investment Strategies and Risk of Loss – Item 8

A. How does the requirement to identify material risks associated with significant strategies apply in the context of a multistrategy investment adviser that offers many (for example, as many as 50 or more) different investment strategies? In such a case, is it sufficient to explain that investing in securities involves risk of loss?

B. How does the SEC staff define an "investment strategy" for purposes of this item? Is it sufficient to refer to the general "investment strategies" identified in Item 4.C of the current Form ADV Part II (*e.g.*, long-term purchases, short-term purchases, trading, short sales, margin transactions, option writing) instead of identifying the risks associated with each different investment strategy that a firm markets to clients? Alternatively, may a firm group its investment strategies into broad categories and identify material risks associated with each separate category?

C. In the case of investment strategies offered exclusively through pooled investment vehicles, please confirm that a firm may refer clients to prospectuses and private offering memoranda for a description of material risk factors rather than duplicating the discussion of risk factors in the brochure.

D. The adopting release states that the SEC recognizes that "the brochure may not always be the best place for a multistrategy adviser to disclose risks associated with all of its methods of analysis or strategies." However, the adopting release does not affirmatively state that a multistrategy firm may omit this information from its brochure. Please confirm that multistrategy firms are not required to respond to Item 8.B in their brochures for methods of analysis or strategies that either are not "significant" or in those cases where the risks associated with particular methods of analysis or strategies are described elsewhere (*e.g.*, in risk disclosure brochures or investment policy statements).

E. May an investment adviser take the position that a method of analysis or investment strategy is not "significant" if it represents 10% or less of an investment adviser's assets under management?

We appreciate the staff's consideration of the issues, requests and questions discussed in this memorandum and would welcome the opportunity to talk or meet to discuss these matters further. We will follow up in a few days to touch base with you on these matters, but please feel free to reach out to us with any questions in the meantime.

c: Ira Hammerman, SIFMA
Kevin Carroll, SIFMA
Members, Form ADV Working Group

<u>Exhibits</u>:

Exhibit 1 Important Metrics Affecting Ability of Large Firms to Meet Current Brochure Delivery Deadlines

Exhibit 2 Process for Rolling out Brochure Supplements

Exhibit 3 Technology Freeze Dates for Largest Firms

EXHIBIT 1

Important Metrics Affecting the Ability of Large Firms to Meet Current Brochure Delivery Deadlines (Survey of 12 Representative SIFMA Member Firms)

Metric	**Aggregate for 12 Firms Surveyed**	**Average for Largest 5 Firms**
Number of registered representatives	83,219	14,310
Number of supervised persons possibly involved in formulating advice and for which brochure supplements may be required	65,296	10,938
Number of teams/partnerships	38,868	10,917
Number of supervisors	7,449	1,248
Number of active advisory accounts	6,099,534	1,017,302
Average number of advisory accounts added per day	4,695	682
Number of systems housing data to be aggregated into the supplement	84	11
Estimate of man hours to develop technology to automate data collection/compilation (only 5 firms have provided estimates)	50,084	15,947

Process for Rolling Out Brochure Supplements

EXHIBIT 2

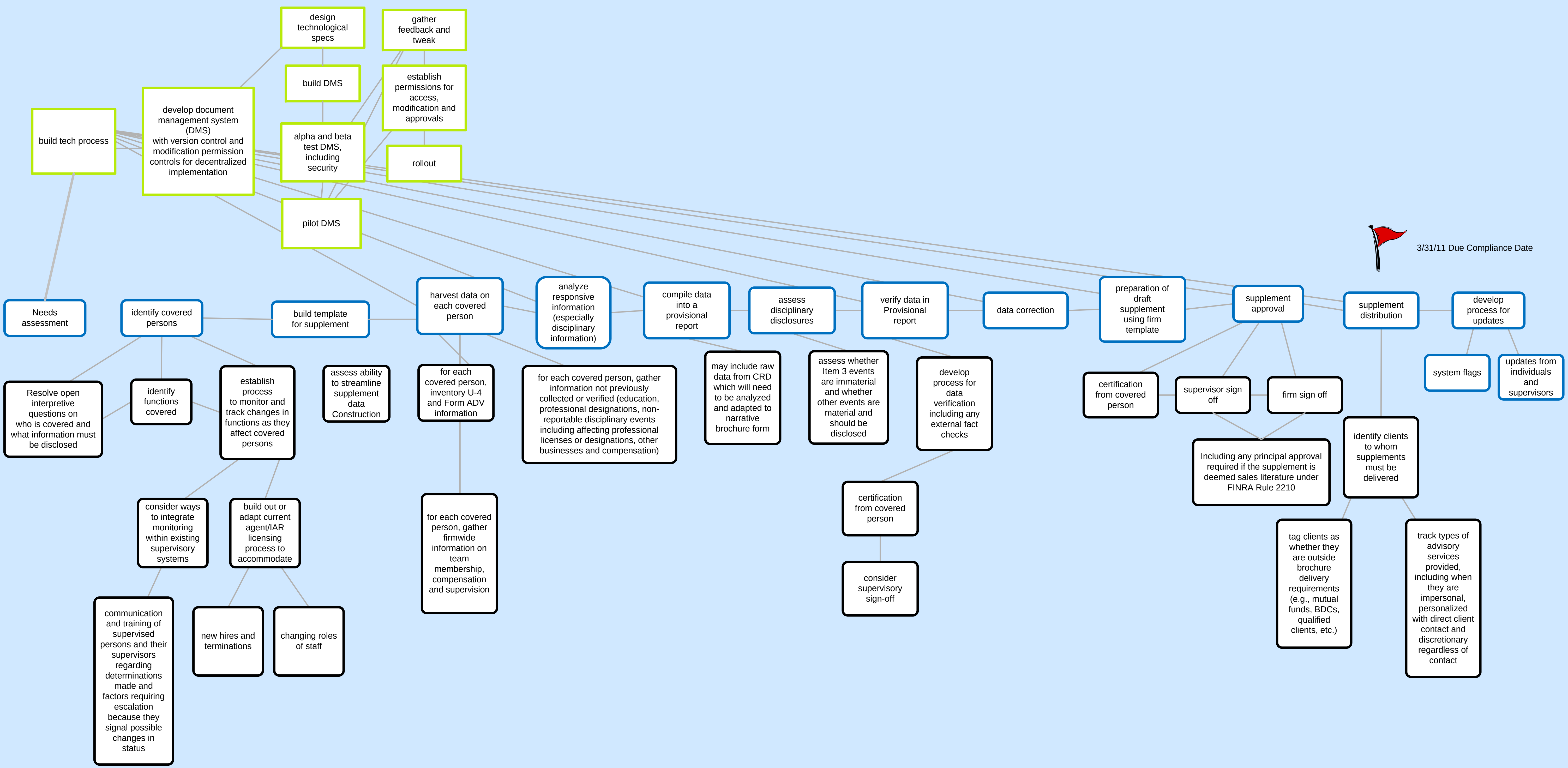

EXHIBIT 3

Technology Freeze Dates for Largest Firms