NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS INC.

May 16, 2008

The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission
Attn: Nancy M. Morris, Secretary 100 F Street, NE
Washington, DC 20549 Electronic Address: rule-comments@sec.gov

Re: File No. S7-10-00 - Proposed Amendments to Form ADV

Dear Secretary Morris:

The National Society of Compliance Professionals (NSCP) appreciates the opportunity to comment on the proposed amendments to Form ADV ("Proposed Amendments") by the Securities and Exchange Commission ("Commission").

The Proposed Amendments are of considerable interest to the NSCP and its members. NSCP is the largest organization of securities industry professionals devoted exclusively to compliance issues, effective supervision, and oversight. The principal purpose of NSCP is to enhance compliance in the securities industry, including firms' compliance efforts and programs and to further the education and professionalism of the individuals implementing those efforts. An important mission of the NSCP is to instill in its members the importance of developing and implementing sound compliance programs across-the-board.

Since its founding in 1987, NSCP has grown to over 1,800 members, and the constituency from which its membership is drawn is unique. NSCP's membership is drawn principally from traditional broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the law firms, accounting firms, and consultants that serve them. The vast majority of NSCP members are compliance and legal personnel, and the asset management members of NSCP span a wide spectrum of firms, including employees from the largest brokerage and investment management firms to those operations with only a handful of employees. The diversity of our membership allows the NSCP to represent a large variety of perspectives in the asset management industry.

General Comments on Proposed Part II

Preliminary Observation

The NSCP strongly supports the Commission's efforts to amend Form ADV, Part II and to make Part II publicly available on the Internet. The Commission's statement of the purposes served by Part II and its importance is endorsed by NSCP:

> Unlike the laws of many other countries, the U.S. federal securities laws do not prescribe minimum experience or qualification requirements for persons providing investment advice. They do not establish maximum fees that advisers may charge. Nor do they preclude advisers from having substantial conflicts of interest that might adversely affect the objectivity of the advice they provide. Rather, investors have the responsibility, based on disclosure they receive, for selecting their own advisers, negotiating their own fee arrangements, and evaluating their advisers' conflicts. Therefore, it is critical that clients and prospective clients receive sufficient information about the adviser and its personnel to permit them to make an informed decision about whether to engage an adviser, and having engaged the adviser, how to manage that relationship.
>
> Our proposal was designed to require advisers to disclose this information in a clearer, more meaningful format than the current check-the-box approach.
>
> We believe that the amendments we are proposing today will greatly improve the ability of clients and prospective clients to evaluate firms offering advisory services and the firms' personnel, and to understand relevant conflicts of interest that the firms and their personnel face and their potential effect on the firms' services.[1]

NSCP notes that the project to revise Form ADV, Part II has been under discussion by the Commission since 1996,[2] that amendments to Part II were first proposed on April 5, 2000,[3] and

---

[1] Advisers Act Rel. 2711 (March 3, 2008).

[2] National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of the United States Code) (NSMIA). Section 303 of NSMIA added new Section 203A(d) of the Advisers Act [15 U.S.C. 80b-3a(d)], which provides that "[t]he Commission may, by rule, require an investment adviser -- (1) to file with the Commission any fee, application, report, or notice required by this title or by the rules issued under this title through any entity designated by the Commission for that purpose; and (2) to pay the reasonable costs associated with such filing." Section 306 of NSMIA provides that "[t]he Commission shall -- (1) provide for the establishment and maintenance of a readily accessible telephonic or other electronic process to receive inquiries regarding disciplinary actions and proceedings involving investment advisers and persons associated with investment advisers; and (2) provide for prompt response to any inquiry described in paragraph (1)." Section 306 was not codified.

[3] Advisers Act Rel 1862 (April 5, 2000).

that Part II has not been publicly available since April 2001.[4] NSCP also notes that the IARD system has been able to accept the electronic filing of Part II, and to make those filings publicly available for free on the Internet, since April 23, 2007. Registered investment advisers have for many years paid fees to the IARD system to make this facility available. Sixteen states already require state-registered advisers to file Part II of Form ADV electronically on the IARD system. NSCP also notes that Part II of Form ADV is the primary disclosure document for registered investment advisers, who, on April 6, 2007, were reported to number 10,446 and to manage $37.65 trillion in assets for nearly $20 millions Americans.[5] NSCP strongly urges the Commission to act expeditiously to adopt amendments to Part II to permit it to become again a publicly available document.

General Comment on Financial Services Integration

NSCP notes that advisory disclosure requirements, including Part II, may need to be revisited in the future in connection with an overall review of financial service integration. NSCP notes that there is no comparable document to Form ADV, Part II for broker-dealers. Nor is there a comparable IARD system for commodity trading advisers.[6] As part of a broader, future study of financial service integration, NSCP encourages the Commission to consider whether the disclosure regimes for different types of financial services firms can be better integrated and harmonized.

General Comments on Proposed Part II

Mandated Order of Presentation; Separation of More Critical and Less Critical Information

NSCP strongly supports the plain English narrative format for Part II. This format is much more informative than the current "check the box" format. NSCP also strongly supports the publication of Part II on the IARD system. This will make Part II publicly available for the first time in over six years and will permit investors to access this vital disclosure document quickly and without cost. NSCP recommends that the format for submitting Part II permit the registrant

[4] Advisers Act Rel. 1897 (Sept. 12, 2000)("After April 2001, the Commission will no longer accept paper filings of Form ADV unless the adviser has been granted a hardship exemption.").

[5] Evolution/Revolution: A Profile of the Investment Adviser Profession (Investment Adviser Association, National Regulatory Services, July 30, 2007).

[6] Nonexempt commodity trading advisers and commodity pool operators do, however, have to file and distribute a disclosure document to their clients which is similar to Form ADV, Part II, This document must disclose the following information: "PRINCIPALS, BUSINESS BACKGROUND, THE FUTURES COMMISSION MERCHANT, THE INTRODUCING BROKER, PRINCIPAL RISK FACTORS, THE TRADING PROGRAM, FEES, FEES BASED ON NOMINAL ACCOUNT SIZE, ADDITIONAL DISCLOSURES FOR PARTIALLY-FUNDED ACCOUNTS, CONFLICTS OF INTEREST, LITIGATION, TRADING FOR ITS OWN ACCOUNT, MATERIAL INFORMATION **(**Nothing shall relieve a CTA from the obligation to disclose all material information to existing or prospective clients even if such information is not specifically required to be disclosed pursuant to Commission rules.)" National Futures Association, Disclosure Documents (June 2005). It is noteworthy that these disclosure requirements are remarkably similar to those recommended by NSCP for the most important, first section of Part II.

to include tables and charts, if deemed appropriate. Such visual presentation of information can assist clients in understanding information quickly and has been encouraged by the Commission for other disclosure documents.[7]

NSCP favors a mandated order of presentation for the proposed sections in Part II. This will assist clients in comparing different advisers.[8] NSCP also recommends that Part II be divided into two parts: a first part that contains the most important information about the adviser and a second part that contains less important information. This second part could be designated in the filing with the caption "Appendix" or "Statement of Additional Information." Again, this separation of the most critical information about the adviser from less critical information will facilitate more efficient client review of the information.

NSCP proposes the following order of presentation:

First Section of Part II

Item 4 – Description of business

Item 8 – Investment Strategies and Risks

Items 5 and 6– Fees and Compensation and Performance Fees

Item 7 – Types of Clients

Item 9 – Disciplinary History

Items 10 and 11 – Code of Ethics and Personal Conflicts

Appendix to Part II or Statement of Additional Information

Item 12 – Brokerage Practices

Item 13 – Review of Accounts

Item 14 – Payments for Referrals

Item 15 – Custody

Item 16 – Investment Discretion

---

[7] Plain English Handbook at p. 49 ("Graphics often illuminate information more clearly and quickly than text.").

[8] This approach was recognized by the Commission when it amended mutual fund prospectuses: "The Commission has concluded that the possibility that the risk/return summary could repeat some information appearing elsewhere in the prospectus is outweighed by the benefits of providing investors with standardized and comparable fund information at the beginning of every prospectus and in the profile." Sec. Act Rel 7512 (March 13, 1998).

Item 17 – Proxy Voting

Item 18 – Financial Information

As noted below, however, NSCP has comments on certain of the proposed disclosures under the Items listed above.

NSCP also notes that the Financial Services Authority ("FSA") in the United Kingdom is also revising its required disclosure document for investment managers. The FSA effort has reportedly been informed by focus group meetings with investors who have been asked to comment on various disclosure formats. The current FSA proposal would require the mandatory disclosure document to contain the following information:

Section 1 – The Financial Services Authority

This section explains the purpose of the document to consumers, explaining that we have designed the document and it contains information to help consumers decide if a firm's services are right for them. It also suggests to consumers that it is not simply a piece of marketing literature from the firm.

Section 2 – Whose products do we offer?

This section explains the scope of the services that a firm is offering on packaged products to a particular client. Together with Section 3, it explains whether the firm will be advising on or arranging packaged products from the whole market, a limited number of companies, or a single company or company group. In this section firms can also include a further explanation of any additional factors they think are relevant, bearing in mind the explanation of whose products the firm offers should be fair, clear and not misleading.

Section 3 – Which service will we provide you with?

This section tells consumers whether they: • are receiving advice and recommendations from the adviser; • have to make a choice for themselves; or • are receiving basic advice on a limited range of stakeholder products. Additionally, firms can choose to include a list of services or the products they offer advice on.

Section 4 – What will you have to pay us for our services?

This section explains how the consumer will pay the firm for its services, whether by fee, by commission, by a combination of fee and commission, or by some other means. If several payment options are available, each option will be explained in clear and plain language. Additionally, if firms receive non-monetary benefits, they may choose to provide summary disclosure regarding these benefits in this section, under the heading 'Other benefits we may receive.'

Section 5 – Who regulates us?

This section tells the consumer the firm is authorised and regulated by us, the scope of its permitted business in relation to packaged products and details of where they can check this information.

Section 6 – Loans and ownership

This section tells consumers of interests (share capital, voting rights or both) held in and/or loans provided to firms by product providers and vice versa. This should alert customers to the potential for these interests and loans to influence the firm and bias the product recommendations the customer receives.

Section 7 – What to do if you have a complaint?

This section explains to consumers what they should do if they have a complaint.

Section 8 – Are we covered by the Financial Services Compensation Scheme?

This section tells consumers whether the firm is covered by the Financial Services Compensation Scheme.[9]

NSCP notes that this disclosure is remarkably similar to that proposed by NSCP, with one significant difference. The FSA would require investment managers to explain how they are regulated and the implications of that regulation. Although the Commission has historically avoided such disclosures, NSCP believes there is merit to including such information in Part II. The Commission could develop a standardized statement that could be included in all Part IIs. This could significantly improve investor understanding and, according to FSA studies, could be helpful to the investing public.

Proposed "Point-of Sale" Disclosures Are Unwarranted

In two sections, the proposed amendments to Form ADV discuss a "point of sale" disclosure document that would be unique to each client. This is mentioned in a proposal for disclosure of risks to clients.[10] Second, it is proposed that a "brochure supplement," designated as Part IIB,

[9] Consultation Paper 08-3 "Simplifying Disclosure: Information About Services and Costs" (Feb. 19, 2008).

[10] "Multi-strategy advisers must already disclose the risks associated with strategies that they recommend to clients, but the brochure may not be the best place to make that disclosure. For example, disclosure of this information may lengthen the brochure unnecessarily given that different clients would be pursuing different strategies, each of which poses specific and different risks, and clients may only need to understand the risks to which they are exposed. Accordingly, we would not require these advisers to list in the brochure the risks involved in each type of security or trading strategy. In such cases, required risk disclosure with respect to particular strategies could be made separately to those clients to whom such disclosure is relevant."

would be delivered to each advisory client disclosing information about the employees of the adviser who will provide services to the particular client receiving the supplement.[11]

NSCP disfavors adoption of the "point-of sale" disclosure document as part of the amendments to Part II, although NSCP believes that the general subject of mandating a "point-of-sale" disclosure document for advisers merits further study. NSCP opposes the "point-of-sale" approach, particularly the proposed Part IIB, for two reasons. First, a system of "point-of-sale" disclosure is difficult to administer and therefore creates potential liability. The existing Form ADV is a general statement about the entire firm, for all of its clients, and this approach has worked well. Second, consideration of a "point-of-sale" disclosure document for advisers requires more thorough study. It is unclear, for example, why disciplinary history about the personnel servicing a particular client needs to be repeated in a "point-of-sale" disclosure document (such information is already found in Part I), but other information, such as fee arrangements for a particular client, would not be disclosed in a "point-of-sale" document. Extensive further studies of these, and other issues relating to a "point-of-sale" disclosure document, are necessary.

Disclosure in Form ADV Should Not Be Treated as a General Solicitation or Advertising

The proposed Part II could require an adviser to disclose that it offers and manages hedge funds, which are normally offered and sold under the private placement exemption from registration of securities under the Securities Act of 1933, as amended ("Securities Act"), and the Investment Company Act of 1940, as amended ("Investment Company Act"). A condition to reliance on these exemptions is that there be no general solicitation or advertising of the offering by the issuer. Since the Commission clearly does not intend the proposed amendments to Part II to substantially restrict the ability or registered advisers to manage hedge funds, the Commission should make clear that disclosure in Part II is consistent with the private placement exemption under the Securities Act and the Investment Company Act.

Comments on Specific Proposals

Delivery of Amendments

NSCP supports the proposal. However, since the Commission proposes to repeal Rule 206(4)-4 under the Investment Advisers Act of 1940, as amended ("Advisers Act"), NSCP recommends that delivery of Part II be required both when a material disciplinary event is disclosed in an amendment and when the adviser's financial condition threatens to impair its ability to provide advisory services to its clients. NSCP also recommends that Part II include an item that parallels Rule 206(4)-4 to require disclosure of a "financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients."

---

[11] "[W]e proposed in 2000, and are today reproposing, a requirement that adviser brochures be accompanied by brochure supplements that provide information about the advisory personnel on whom clients rely for investment advice. A brochure supplement ordinarily would be less than a page long and would contain information about the educational background, business experience, and disciplinary history (if any) of the supervised person who provides advisory services to that client."

Item 2 – Material Changes

NSCP opposes the proposal that "advisers provide clients with a summary of any material changes to their brochures since the last annual update." This should be unnecessary since the Part II will be sufficiently clear and simple for clients to review it and identify all material information, including any material changes from the prior Part II. This proposal would thus create needless work for advisers, with corresponding costs and potential liability, with no benefit to clients.

Item 5 Fees and Compensation

NSCP finds the following proposals confusing and somewhat inconsistent:

> We are also proposing in Item 5 a requirement that advisers that receive compensation attributable to the sale of a security or other investment product (*e.g.*, brokerage commissions), or whose personnel receive such compensation, must disclose this practice and the conflict of interest it creates and describe how the adviser addresses this conflict. . . We are not proposing a requirement that advisers must disclose the amount or range of mutual fund fees or other third-party fees that clients may pay.

NSCP recommends that the disclosure of fees and compensation remain simple and clear and be confined to disclosure of advisory fees. Other compensation received by the adviser in connection with investments for clients could be disclosed in a section discussing potential conflicts of interest. Any discussion of potential conflicts of interest should be comprehensive and consistent. There is no reason to treat mutual fund fees differently from any other fees the adviser may receive in connection with investments for its clients.

Item 8 – Investment Strategies and Risks

NSCP is concerned that more guidance needs to be provided about how an adviser should define "risks." The Commission has struggled with this concept for decades[12] and has explained the complexity of defining risk. In addition, without additional guidance from the Commission, advisers may feel compelled to disclose so much about their investment strategies that competitors could front-run or piggy-back on those strategies to the detriment of the adviser and its clients.

NSCP recommends that the Commission adopt the approach it followed with respect to risk disclosures in mutual fund prospectuses and specify that the required disclosure should discuss the risks associated with the entire portfolio rather than individual investments.[13]

---

[12] "Improving Descriptions of Risk by Mutual Funds and Other Investment Companies," Release No. 33-7153 (March 29, 1995).

[13] Sec. Act Rel 7512 (March 13, 1998) ("In the Form N-1A Proposing Release, the Commission discussed its concerns about disclosure of fund investments and risks typically found in many fund prospectuses. This disclosure generally consists of descriptions of the types of securities in which a fund may invest and the risks associated with

Item 9 – Disciplinary History

NSCP supports disclosure of arbitration awards, but only if the settlements or awards are large (over $100,000). NSCP also recommends that arbitration awards be disclosed for a shorter period than other types of disciplinary actions, perhaps for three years from the date of the award. The reasons for this are simple. Arbitration proceedings are more informal than other forms of litigation and can sometimes be unfair to the adviser. Some commentators have asserted that arbitrators tend to be less decisive than judges and therefore tend to award small amounts of damages to claimants whose claims lack merit. All of these reasons suggest that any disclosures relating to arbitrations should be more limited than the disclosures that are required for all other types of disciplinary actions.

As noted above, NSCP recommends that a disclosure requirement be added to require the adviser to disclose a "financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients."

Items 10 and 11 - Other Financial Industry Activities and Affiliations and Code of Ethics and Personal Conflicts

The Commission asks whether the proposed disclosures adequately inform clients about conflicts of interest. NSCP favors a broad, and more open-ended, approach to disclosures of potential conflicts of interest. In this regard, it is instructive to refer back to a 2003 speech by the then Director of the Commission's Division of Enforcement, who asked all firms, included broker-dealers and advisers, to review conflicts of interest and to make appropriate disclosure of those conflicts:

> I call upon every financial services firm to undertake a top-to-bottom review of its business operations with the goal of addressing conflicts of interest of every kind. No one is in a better position than you to identify the conflicts that arise from a financial services firm's efforts to pursue business profitability. I encourage you to approach the task systematically. You should search for those business practices that have the potential to sacrifice the interests of one set of customers in favor of the interests of another. You also should identify any situations in which

---

each of those securities. In the Commission's view, disclosing information about all of the securities in which a fund might invest does not help a typical fund investor evaluate how the fund's portfolio will be managed or the overall risks of investing in the fund. The disclosure also adds substantial length and complexity to fund prospectuses, which discourages investors from reading them. The Commission has concluded that prospectus disclosure would be more useful to a typical fund investor if it emphasized the principal investment strategies of a fund and the principal risks of investing in the fund, rather than the characteristics and risks of each type of instrument in which the fund may invest. The Commission believes that funds are appropriately viewed as a means through which a professional money manager provides its services to investors and that, for that reason, the focus of disclosure about a fund's prospective investments should center on the fund's investment objectives and the principal means used by the fund's adviser to achieve those objectives.").

the firm could place its or its employees' interests ahead of the firm's customers. Both types of conflicts need to be eliminated or disclosed.[14]

NSCP favors this open-ended approach to conflicts disclosure.

Item 17 – Proxy Voting

Item 17 of the instructions to Form ADV Part II (pages 149-150 of the proposed released) requires investment advisers to describe: their proxy voting policies and procedures, whether clients can direct an adviser to vote in a particular solicitation, how conflicts of interest between an adviser and a client are addressed, how clients may obtain information about how a client's proxies were voted and how clients may obtain a copy of an adviser's proxy voting policies and procedures.

The extent of the existing disclosures sufficiently provides client and/or prospective clients with adequate information regarding an adviser's proxy voting practices and is consistent with the requirements set forth in Rule 206(4)-6 of the Advisers Act.

In regards to the proposal requiring additional detailed disclosure about the use of a third party proxy services in Form ADV, the Commission should let advisers decide if such disclosures are needed. For example, disclosure would not be helpful for those advisers who vote proxies for a small percentage of their clients and such disclosure would not be relevant to the vast majority of the adviser's clients. Instead, disclosure regarding third party proxy voting services may be more appropriate in a separate document, for example, such as the investment management agreement or a document summarizing an adviser's proxy voting policies and procedures. This information may also be included on an adviser's website.

With respect to the proposal requiring disclosure of how proxy-voting services are paid for, this disclosure should be limited to situations where such services are paid for other than with hard dollars, such as through soft dollars or other types of non-cash compensation arrangements.

---

[14] Stephen M. Cutler, Director, Division of Enforcement, SEC, "Remarks Before The National Regulatory Services Investment Adviser and Broker-Dealer Compliance/Risk Management Conference" (Sept. 9, 2003). See also for a broad definition of conflicts of interest in the advisory industry, Chester S. Spatt, Chief Economist and Director, Office of Economic Analysis, SEC, "Conflicts of Interest in Asset Management" (May 12, 2005)("Now I would like to explore in a bit more detail various examples of conflicting incentives that arise in asset management. I should note that the examples I have in mind, a few of which I already have briefly touched upon, are quite varied and arise at various levels - emphasizing the hierarchical nature of incentive conflicts. These issues arise in such settings as product distribution (between advisers and brokers) and its influence upon the investor's decision to select particular fund products, the production of information including the roles of "soft dollars" and analysts-which in the case of analysts relates to the allocation of "hot" IPOs (Initial Public Offerings), risk and asset allocation decisions by fund advisers, the role of fund advisers in protecting uninformed investors against "market timing" and late trading and following explicit voluntary disclosures specified in their prospectuses, the allocation of trades within a fund complex and finally, the order routing decision including the influence of "payment for order flow" and the import of "Best Execution" practices. ").

For advisers that pay hard dollars to third party proxy service providers, a requirement to disclose a dollar amount in the Form ADV would not be meaningful to clients. The cost an adviser pays for a third party proxy voting service is no more significant than what it pays for portfolio accounting, statement production, and other administrative back office services. It is likely that amounts could vary greatly among advisers, even for those with similar assets under management and number of accounts. The amount an adviser pays to a third party proxy service provider is based on a number of factors such as the level of service received, the number of clients, the number of proxies voted, the use of standard guidelines, research necessary for each particular vote, proxy voting administration (receiving and processing ballots), and proxy report statement generation. Due to all of these factors, investors will not be in a position to understand the reasons for the variations in proxy voting costs among advisers.

Lastly, most advisers do not increase their advisory fee or charge clients an additional fee to vote proxies. It seems inconsistent to require advisers that use a third party proxy service provider to disclose the amounts paid and not to require the same disclosure for advisers that elect to vote proxies in-house.

Other Observations

NSCP agrees with the proposal that Part II should not require disclosure of the standards the adviser uses to prepare advertised investment performance. This issue is better left to a review of advertising rules. Consideration of this issue in connection with Part II interjects unnecessary issues that could needlessly delay the adoption of Part II and merit separate consideration through separate detailed rule-making.

NSCP recommends that Part II identify the adviser's Chief Compliance Officer. This will enhance the recognition and importance of this vital function and thereby help to strengthen advisers' cultures of compliance.

NSCP notes that the Commission appears to permit advisers to satisfy all of their disclosure obligations to clients through the electronic filing of Part II on the IARD system. In this regard, NSCP notes that many clients, particularly senior citizens, may not have access to the Internet or may prefer to receive Part II in a paper format. NSCP encourages the Commission to permit clients to request delivery of Part II in a paper format.[15] In addition, the Commission may wish to consider permitting senior citizens to request a large type version of Part II. This would be consistent with the Commission's overall initiative to better inform and protect senior citizens.

Finally, NSCP encourages the Commission to consider whether a more simple version of Part II could be required for small firms. The costs of compliance with Commission requirements are already a heavy burden for small firms. Under NSCP's proposal that Part II be divided into two parts, as explained above, it would be logical to require smaller firms to complete only the first, and most important, section of Part II as a means of decreasing the burden and costs of compliance on such firms.

---

[15] See Sec. Act Rel. 7856 (April 28, 2000).

* * * * *

NSCP urges the Commission to act expeditiously to adopt proposed amendments to Part II of Form ADV. It is critical, in NSCP's view, that Part II again become publicly available. The IARD system is the ideal vehicle to facilitate this.

Questions regarding our comments or requests for additional information should be directed to the undersigned at 860.672.0843.

Sincerely yours,

Joan Hinchman
Executive Director, President and CEO

cc via postal mail: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey

Andrew J. Donohue, Director,
Division of Investment Management

Robert E. Plaze, Associate Director,
Division of Investment Management

David W. Blass, Assistant Director,
Office of Investment Adviser Regulation

Daniel S. Kohn, Branch Chief
Office of Investment Adviser Regulation