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Submission via e-mail

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Nancy M. Morris, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: File No. S7-10-00
Form ADV Part 2 - Plain English Brochure - Proposed Amendments

Dear SEC,

I am pleased to see the SEC move forward on revisions to Form ADV Part 2, and to provide my comments to the proposed amendments. As a compliance consultant to investment advisory firms (both fee-only and dual registrants), I provide a broad perspective as to how the proposed changes will affect many SEC registrants.

General Comments

I support the proposal that requires advisors to explain succinctly how they address conflicts of interest they identify, and not be required to disclose their policies and procedures.

I support the proposal that advisors need not repeat information simply because it is responsive to more than one item. The Table of Contents will be able to identify where clients can seek responses to specific items. The Index also serves this purpose.

Delivery and Updating

I am concerned about requiring delivery of the Form ADV Part 2 annually to all clients. I understand this is similar to the requirement relating to mutual fund prospectuses. And just like mutual fund prospectus updates, most clients do not read the materials.

I am sensitive to the fact that existing clients may not be aware of material updates, and there needs to be a procedure that provides adequate disclosure to clients.

Many "small advisors" may have hundreds of clients. The requirement to mail the actual document to existing clients every year (especially when there are no material changes) is a costly burden on the industry, to which there may be no investor benefit as currently proposed.

The "annual offer" needs to be revised to make it a more effective communication. Currently some advisors make the offer as a line disclosure on an annual client report (and some advisors make the offer on each quarterly client report). I believe requiring a special letter (which can be combined with other information such as the annual privacy notice) is warranted. If there are no material updates, a simple offer of the Form ADV 2 can be made. It would not be necessary to specifically state that there are no material updates (if there are none), since that may have an effect of discouraging client requests.

However, if there are material updates to the Form ADV 2, then the advisor would be required to concisely summarize the updates with enough detail to be meaningful (albeit without full detail) in the annual offer letter. This may encourage more client requests when there is something of substance. This allows clients to make their own decision regarding the disclosure document. When clients have an existing relationship with an advisor, and they are made aware of material updates, and they have the option to obtain more details, I believe the client duty will be fulfilled. This is different from a new client engagement where the client must be able to have full access to the full disclosure document.

Furthermore, in the case of existing client annual offers (but not for new client delivery), clients should have the option to access the brochure online. The annual offer letter can direct them to the URL of the SEC public disclosure website, and to the advisors web site (if the advisor has a web site and if the advisor elects to post the ADV on its own website), and offer to deliver the hard copy at the client request at no charge. Thus, if the client chooses not to ask the advisor to deliver the ADV, the client has more flexibility to view the information in anonymity.

If the SEC does not agree with my conclusions, then I believe the 120 days after the end of the advisor's fiscal year end is reasonable to make such delivery.

On another but related matter, I do not believe that it is necessary to make advisors' historical brochure filings available via the SEC public disclosure Web site. I believe only the current brochure serves the need of the investor.

Part 2A (Firm Brochure)

Item #
1. Cover Page – no comment

2. Material Changes – Consistent with my comments above (delivery and updating), I do not believe that a summary of material changes should be part of the firm brochure. It is not necessary for new clients to read this information. This information can effectively be delivered to existing clients as part of the annual offer letter. As such, it will be given to the persons that need to know in a meaningful manner.

3. Table of Contents – In creating a narrative brochure in plain English, it is important not to force awkward disclosures. Thus it may be important for one advisor to take the topics in one order, and another advisor to use the topics in a different order. Also without forcing standardized titles, I believe it is important for advisors to use key words in titles for ease in investor review. Key words that should be evident in the table of contents and section headings within the brochure include (among others): services, fees, disciplinary, affiliations, brokerage, and referrals.

4. Advisory Business – I question the need to require the amount of client assets managed. Certainly advisors can opt to include the assets under management ("AUM"). I can presume to understand why some may feel this is important – on the theory that more AUM means bigger is better. But this can also be misleading to investors. A one-person operation may appear to have a smaller AUM than an advisory firm with 10 IA Reps. But the larger number can be comprised of smaller portfolios of the 10 IA Reps, making the comparison apples to oranges. Also, a firm specializing in financial planning or wealth management may have little or no AUM. I believe putting the focus on AUM distorts investor understanding.

However, should the SEC chose to move ahead on this proposal, then I do support allowing a different calculation for Part 2. I am aware of a few advisors that currently define their managed accounts differently from Part 1 when calculating the percent of income for Part II. In this case, the advisor should internally document the method used and why. This rational should be made available to a regulator upon request.

Not on point to the comment being requested, but related to calculating AUM, I believe that currently there is over reporting of AUM on ADV Part 1. This is because more than one advisor can claim AUM for reporting purposes when sub-advisor and third party money managers are used. Thus, if the SEC or the industry were to try to aggregate the total of investor AUM handled by advisors, there would be an overstatement. I would like to see clarity (additional guidance) for Part 1 reporting. Furthermore if the proposal is adopted to include AUM in Part 2, and that a different definition could be used, I would still like to restrict the double reporting of client assets by more than one advisor.

I support not listing all wrap fee programs and not listing the names of all periodicals or periodic reports. I further support not listing the names of all third party money managers that clients can be referred to. This list changes, can be lengthy, and clients will get the disclosure at the time the recommendation is made.

I believe that the full disclosure document should disclose all services offered by the advisor. I do not understand the "impracticality" of having to disclose this. Furthermore, if a client offers an array of services that "could be provided" but generally specializes, this should be disclosed. Some advisors offer financial planning when requested by the client, but generally focus on managing a portfolio. This should be made clear to a client so they don't mistakenly assume a financial plan is automatically provided. The current Form ADV Part II (the check the box section) does show the percentage of income from each type of service described. While the actual percentage may not be mandated, the narrative should provide perspective.

5. Fees and Compensation – I reiterate my comments from my June 12, 2000 comment letter. Full disclosure should be provided about advisory fees, including that the client may bear other costs (brokerage commissions and brokerage/custodial fees). Conflicts such as participation in commissions – whether for advisory accounts and/or outside the advisory relationship should be disclosed. All this is currently required. I support the current proposal that mutual fund or other third-party fees do not need to disclose the range of those fees, but that those fees will bear on the costs to clients in addition to advisory fees.

6. Performance Fees and Side-By-Side Management – I am in favor of disclosure of performance fees and disclosing the conflicts that may arise with accounts that do not pay the performance fees for the reasons mentioned.

Furthermore, conflict disclosure for performance fees should be made, "In regards to performance based compensation, the fee arrangement may create an incentive for us to make investments that are riskier or more speculative than would be the case in the absence of a performance based fee. We may receive increased compensation with regard to unrealized appreciation as well as realized gains in the account."

7. Types of Clients – I am in favor of disclosing types of clients and minimums for accounts, as is currently required. I question why these two items are now combined under one item number? If we are trying to consolidate numbers, would not the minimum size account be more conducive with the fee disclosure?

8. Methods of Analysis, Investment Strategies and Risk of Loss – I am in favor of disclosing that investing in securities involves risk of loss, and specific risks for those advisors that use primarily a particular method, strategy, or type of security.

However, I am torn on the issue of multi-strategy firms making certain disclosures outside of the "full" disclosure brochure. (When disclosure involves third-party providers outside the control of the advisor, it makes sense not to include specifics in the brochure.) The strategy of the advisor and the risks applicable to those strategies may make sense for the client to read and compare in the brochure before the advisor steers the client to one strategy and gives the client risks associated only with that one strategy. On the other hand, I am sensitive to making the brochure too long to wade through.

In many cases, the risk disclosure may not be long and thus may not require a separate risk disclosure statement. You have already suggested that advisors would be free to make these full disclosures in the brochure.

My recommended solution is in the cases where more detailed disclosure is needed outside the brochure, that a concise summary of the risks appear in the brochure alongside each strategy, with a statement that more detailed risks are provided at the client request, and also provided at the time the strategy is recommended. This risk disclosure statement can be attached to the brochure as an addendum or supplement. Thus the detailed risk disclosures would be filed with the regulators as an addendum, and only provided to those clients requiring or requesting such disclosure. (This is similar to the supervised person supplement.)

In regards to cash balances, I'm not sure that there is much in the way of disclosure that needs to be made. The one item I can think of is if the advisory fees are charged on cash in the account. It is my assumption that most advisors do charge on cash balances, as it is part of the assets they are managing, if it is placed in the trading account. Of course clients can place restrictions on the amount of cash that is to be held in the account (as they can place any reasonable restriction on the account). I would hope however that clients that need a cash reserve hold those funds outside the advisory account.

The other item that should be disclosed is when margin is used, if advisory fees are charged on the full value of the securities in the account or only the fully paid for portion. If fees are charged on the full value, then a conflict statement should be included that this creates incentive for the advisor to trade on margin.

9. Disciplinary Information – Material disciplinary information should be disclosed in the brochure. For now I will defer to other legal experts as to what constitutes material.

I do not believe that you should require delivery of any types of orders, except where stipulated in the order itself.

10. Other Financial Industry Activities and Affiliations – This is similar to current information being captured, and should continue to be disclosed. On the current Form ADV Part II it is disclosed at item 8 if the parties are related, and at item 13 "other compensation" as a catch-all if the parties are not related. This sometimes causes redundancies, albeit differentiated in part, in the narrative. I believe there can be material relationships for these categories of firms that need to be disclosed regardless if firms or persons are related or not. While it is true that the related relationships require more conflict disclosure, the flow of the narrative may be better served by grouping all of these under one item number. This item would thus also flow into proposed item 12 Brokerage Practices and how advisors select brokerage firms.

I agree with the proposal that the SEC does not define which relationships or arrangements are material, due to the diversity of such relationships.

11. Code of Ethics – No comment at this time.

12. Brokerage Practices – In regards to soft dollar disclosure, it was noted that some commenters questioned the conflicts the SEC identified and complained that the item would tend to cast aspersions on the use of soft dollar arrangements that are commonplace. The SEC countered that it is not the intent to create a negative impression regarding soft dollars.

Unfortunately, the problem of soft dollar disclosure goes beyond ADV disclosure and goes directly to the Section 28(e) safe harbor as it is currently written. Technology and electronic access has outpaced the safe harbor provisions. Eligible brokerage relates to the execution of the trade from the point at which the money manager communicates with the BD for the purpose of transmitting an order for execution, through the point at which funds or securities are delivered or credited to the advised account. But that very same electronic access gives seamless access to ineligible brokerage products and services to monitor portfolios, surveillance, transmit advisory fees, and for recordkeeping or administrative functions. And to try to put a dollar value on this "mixed use" item is an exercise in futility. It's free and it's commonplace. To try to explain what is included in the safe harbor and what is not, just seems to put a negative spin on it. When everybody gets these items, and thus all advisors have to disclose this, it tends to get buried under boilerplate.

What should be disclosed in the Form ADV as to soft dollars are those items that are negotiated as a special deal and not readily available to all advisors. The items that should require special conflict disclosure include (among others): computer terminals, proxy services, travel, salaries, and marketing.

13. Review of Accounts – No comment at this time.

14. Payment for Client Referrals – No comment at this time.

15. Custody – No comment at this time.

16. Investment Discretion – No comment at this time.

17. Voting Client Securities – To the extent the proposal is the same as the current disclosure, I have no comment. However the new information regarding third-party proxy voting services seems to get into the minutia. I don't think most clients would be interested in most of the information proposed.

A list of proxy-service providers by name is subject to change. If a client has an interest in knowing this information, it can be asked and the names can be provided orally. The selection process is generally not of concern to clients.

It is important to include a general disclosure that third-party proxy services may be utilized or if the advisor votes. It is not important how much the advisor pays for these services. It would be important disclosure if the advisor pays with soft dollars, as this is not a commonplace use of soft dollars outside the safe harbor. Any other items that may be deemed to be a conflict should be disclosed (such as an affiliation with the proxy service), but the SEC should not define or list the conflicts, as this can be varied.

18. Financial Information – I support the increase in the prepayment threshold to $1,200.

19. Index [for IARD filing purposes] – I support the index.

Part 2A Appendix 1 (Wrap Fee Program Brochure)

Although the current Schedule H Wrap Fee Brochure must be separate from the standard advisory firm brochure, I believe there are instances where it is more efficient to consolidate this information. I am aware of advisors that were interested in creating a wrap program, but when advised it would require a separate disclosure document, they decided to simply quote advisory fees separate from brokerage fees. Advisors should have the option to decide if a separate brochure makes sense for their practice.

Part 2B (Supervised Person Supplement)

I am pleased about the approach the SEC is taking with the supplement. The use of the supplement is a valuable way to cut down unnecessary text in the main brochure that goes to all clients. Clients will get the necessary information on the supervised person that is handling their account. Furthermore, the supplement is not necessary (as in the case of smaller firms) where all the applicable information may be included in the firm brochure.

1. Cover Page – For a one page supplement a cover page is unnecessary. The name of the person and the firm can be included on a single page with the other information. It can then be attached to the back of the firm brochure. Optionally a firm could choose to use a separate cover page.

2. Educational Background and Business Experience – No comment at this time.

3. Disciplinary Information – No comment at this time.

4. Other Business Activities – I support eliminating unnecessary disclosure about relatively insignificant other business activities, while requiring important disclosures of primary business activities.

5. Additional Compensation – No comment at this time.

6. Supervision – No comment at this time.

Filing Requirement

I support PDF filings as the most flexible and cost-efficient approach. If an advisor currently does not have PDF conversion software, it is readily accessible.

XBRL technology is not commonplace and may be too sophisticated for many small advisors.

I believe it is reasonable not to require the filing of the supervised person supplement.

A six-month period minimum from the effective date, or by the date of the next annual updating amendment, which ever occurs last, is sufficient time for existing firms to prepare new brochures. Most of the information is already disclosed in the existing Form ADV. While there is some new information to disclose, for the most part it will entail a rewrite into plain English.

Firms with a large number of supervised persons may need the most time to prepare the new supplements.

Amendments to Glossary

To add clarity to the term “brochure supplement” I propose it be referred to as “supervised person supplement.”

Sincerely,

Nancy Lininger, Founder/Consultant
The Consortium