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May 16, 2008

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

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

Dear Ms. Morris:

We are submitting this letter on behalf of our client, Federated Investors, Inc. ("Federated"),[1] regarding the Securities and Exchange Commission's (the "Commission") reproposal of amendments ("Proposed Amendments") to Part 2 of Form ADV and related rules under the Investment Advisers Act of 1940 ("Advisers Act").[2] The Proposed Amendments would require investment advisers registered with the Commission to deliver to clients and prospective clients[3] a narrative firm brochure written in plain English. The Proposed Amendments would require that an investment adviser provide brochure supplements to certain clients. Under the Proposed Amendments, a sponsor of a wrap fee program also

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1 Federated is one of the largest asset management firms in the United States. Through its investment adviser subsidiaries, Federated managed more than $338 billion in total assets as of March 31, 2008.

2 *See Amendments to Form ADV*, SEC Release No. IA-2711; 34-57419 (March 14, 2008), 73 Fed. Reg. 13958 (March 14, 2008) (the "Proposing Release"). The Proposing Release incorporates comments the Commission received on the amendments to Part 2 originally proposed in April, 2000, many of which were similar to the current Proposed Amendments. *See Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV*, SEC Release No. IA-1862 (Apr. 5, 2000), 65 Fed. Reg. 20524 (Apr. 17, 2000) (the "2000 Proposed Amendments").

3 For purposes of this letter, unless otherwise indicated, references to "clients" mean "clients and/or prospective clients."

would continue to be required to provide a separate wrap fee program brochure. Specifically, the Proposed Amendments would:

- Amend Part 2 of Form ADV to include (1) Part 2A, which would require investment advisers to file with the Commission and deliver to clients a narrative firm brochure; and (2) Part 2B, which would require investment advisers to provide to certain clients a supplemental brochure containing information about the advisory personnel on which clients rely for investment advice;

- Amend the General Instructions and Glossary of Terms for Form ADV;

- Amend the delivery requirements of Rule 204-3 under the Advisers Act;

- Amend the recordkeeping requirements of Rule 204-2 under the Advisers Act; and

- Withdraw Rule 206(4)-4 under the Advisers Act (which requires investment advisers to disclose certain financial and disciplinary information to clients) as being duplicative.

The stated purpose of the Proposed Amendments is to require investment advisers to provide clients with clear, current, and more meaningful disclosure regarding their business practices, conflicts of interest and background, and their advisory personnel.

Federated commends the Commission on its efforts to modernize the investment adviser disclosure regime and supports the Commission's objective of requiring investment advisers to provide clearly written, meaningful narrative disclosure to clients. Federated believes, however, that the modernization of the disclosure regime and the provision of more meaningful disclosure to clients may be further enhanced by modifying certain requirements that the Commission has included in the Proposed Amendments. As discussed in more detail below, Federated believes that certain proposed requirements may not, in each instance, result in more meaningful disclosure to clients and are unnecessarily costly and administratively burdensome to investment advisers, particularly when compared to the potential benefits to be derived by clients. Accordingly, Federated makes a number of recommendations that Federated believes will address its concerns in a manner consistent with the Commission's objectives. Federated also urges the Commission to take this opportunity to confirm and/or clarify certain matters with respect to the Proposed Amendments. Finally, Federated believes that the Commission's estimates regarding the time and cost burdens that will be imposed on investment advisers in order to comply with the Proposed Amendments are understated. Our comments are set forth in detail below.

As a member of the Investment Company Institute ("ICI"), Federated also generally is in accord with, and supports, the revisions to the Proposed Amendments recommended by the ICI in its comment

letter (the "ICI Comment Letter") to the extent that they are not inconsistent with Federated's comments set forth in this letter.[4]

## I. Proposed Format and Approach

### A. Summary And/Or Consistent Disclosure That Would Permit Clients to Compare And Contrast Investment Advisers Would Be More Meaningful Disclosure

The Proposed Amendments would require an investment adviser's brochure to be written in a narrative format in plain English, as opposed to a "check-the-box" format. While a table of contents would be required in the brochure, and an index would be required to be included in the brochures filed with the Commission, the Proposed Amendments would not require a standardized format or consistent order in which disclosure must appear.

Federated believes that the Commission's goal of providing clearly written, meaningful narrative disclosure to clients would be better served by permitting an investment adviser to satisfy its brochure obligations by sending or giving certain key information in the form of a summary brochure and providing a complete brochure on an Internet Web site. The Commission has already proposed a similar approach with respect to mutual fund prospectus delivery requirements.[5] If the Commission does not elect to adopt this layered approach to disclosure, Federated urges the Commission to require that summary information (whether in a summary table or check-the-box format[6]) be included at the beginning of the brochure.[7] Federated also urges the Commission to require a standardized table of contents and consistent order for required disclosures, whether in a summary brochure, a summary table at the beginning of a brochure, or in the brochure itself.

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4 *See* Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, May 16, 2008.

5 *See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies*, SEC Release Nos. 33-8861 and IC-28064 (Nov. 21, 2007), 72 Fed. Reg. 67790 (Nov. 30, 2007). *See also Securities Offering Reform*, SEC Release Nos. 33-8591, 34-52056, and IC-26993 (July 19, 2005), 70 Fed. Reg. 44722 (Aug. 3, 2005); *Internet Availability of Proxy Materials*, SEC Release Nos. 34-55146 and IC-27671 (Jan. 22, 2007), 72 Fed. Reg. 4148 (Jan. 29, 2007) ("Proxy Voting Release"); and *Shareholder Choice Regarding Proxy Materials*, SEC Release Nos. 34-56135 and IC-27911 (July 26, 2007), 72 Fed. Reg. 42222 (Aug. 1, 2007).

6 Any "check-the-box" format should provide space to allow an investment adviser to briefly clarify a selected item if the investment adviser believes the item does not fully encompass the investment adviser's practices with respect to that item.

7 Federated believes that the information to be included in a summary table or "check-the-box" format could be simplified from the current "check-the-box" requirements in current Form ADV, Part 2, and could include, for example: Adviser Name, Date Advisory Business Commenced, Types of Advisory Services Provided, Types of Fees Charged, Types of Securities on Which Advice is Given, Number and Type of Clients, Brokerage Practices (*e.g.*, permit use of soft dollars, directed brokerage), Whether the Adviser Will Accept Custody of Client Accounts, and Whether the Adviser Will Vote Proxies. The summary table or "check-the-box" format also could contain information regarding the potential conflicts of interest faced by an investment adviser.

Similar to the rationale supporting the Commission's summary prospectus proposal, Federated's foregoing recommendations would permit clients to more readily compare and contrast investment advisers and make informed decisions regarding which investment adviser to select to manage the clients' assets. Although the flexible format proposed by the Commission requires a table of contents, and the electronically filed brochure would be required to contain an index, using these tools to compare investment advisers will require more, and in Federated's view, unnecessary, effort by clients. In the case of the summary brochure proposal, it also would allow clients the freedom to elect to obtain more specific information about an investment adviser by downloading a complete brochure from a designated website.

### B. Conflict Of Interest Disclosure Is More Meaningful Disclosure For Clients Than Disclosure Of Policies And Procedures

The Proposed Amendments include several disclosure items that would require investment advisers to explain succinctly how they address conflicts of interest, rather than requiring investment advisers to disclose their policies and procedures.[8] Federated agrees with the Commission's approach insofar as it does not require the disclosure of investment advisers' policies and procedures in the brochure. Disclosure of policies and procedures in the brochure would not be appropriate because specific policies and procedures change based on business practices and market conditions and often contain confidential or proprietary information. Requiring the disclosure of policies and procedures also would make the brochure unnecessarily long and technical, filled with "legalese" and, ultimately, less meaningful for clients. Federated is concerned, however, that the negative connotations of some of the disclosure items concerning conflicts of interest could lead clients to assume that investment advisers' practices are harmful or in breach of their fiduciary duties or other obligations under the Advisers Act or other applicable law.[9] Federated recommends that the Commission expressly recognize in any adopting release for Form ADV amendments that (1) disclosure regarding conflicts of interest is beneficial to clients (and, in fact, encouraged by the Commission) in that such disclosure permits clients to make more informed decisions regarding investment advisers, and (2) disclosure regarding conflicts of interest does not, in any particular case, suggest that investment advisers are conducting their businesses in

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8 For example, proposed Item 6 of Part 2A of Form ADV would require investment advisers that charge performance fees (or who have supervised persons who manage accounts that charge such fees) to disclose this fact in the investment advisers' brochures. If such investment advisers also manage accounts that are not charged performance fees, the disclosure item also would require the investment advisers to discuss the conflicts that arise from their (or their supervised persons') simultaneous management of these accounts, and to describe generally how the investment advisers addressed those conflicts. *See also* Proposed Item 5 (Fees and Compensation), Proposed Item 10 (Other Financial Activities and Affiliations), Proposed Item 11 (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading), Proposed Item 12 (Brokerage Practices), and Proposed Item 17 (Voting Client Securities) in Part 2A of Form ADV; Proposed Appendix 1 to Part 2A of Form ADV (Wrap Fee Program Brochure); and Proposed Item 4 (Other Business Activities) in Part 2B of Form ADV.

9 Federated's comment is consistent with the ICI Comment Letter regarding the negative connotations that may be derived from some of the disclosure items, such as, for example, Item 12 (relating to soft dollars).

contravention of their fiduciary duties or applicable requirements under the Advisers Act or other applicable law.[10]

## II. Proposed Initial Delivery Requirements

### A. Delivery Requirements For "Qualified Purchaser" Clients Should Be Consistent

The Proposed Amendments would require an investment adviser (or its supervised person) to deliver a current firm brochure before or at the time it enters into an advisory contract with a client, unless the client is a registered investment company or a business development company subject to Section 15(c) of the Investment Company Act of 1940 ("1940 Act"), or the client is receiving only "impersonal advisory services" for which the investment adviser charges less than $500 per year.[11] The Commission declined to propose an exception to the initial brochure delivery requirements for institutional clients that are "qualified purchasers."[12] In contrast, the Commission took an opposite approach in the Proposed Amendments with respect to the delivery requirements for brochure supplements. Specifically, in the Proposed Amendments, the Commission recognized the sophistication of these clients and that they "do not need the protections of the brochure supplement requirement because they are in a position to obtain, and frequently do obtain, information about the advisory personnel on whom they rely for investment advice."

In its comments to the 2000 Proposed Amendments, Federated commented that an exception to the delivery requirements should be made for institutional clients that are "qualified purchasers" for purposes of Section 3(c)(7) under the 1940 Act.[13] Federated again urges the Commission to take a consistent approach with respect to these "qualified purchaser" clients by adopting an additional exception to the initial delivery requirements for institutional clients that are "qualified purchasers" for purposes of Section 3(c)(7) of the 1940 Act.

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10 For example, Section 205(b) of the Advisers Act, and Rule 205-3, specifically permit investment advisers to receive performance-based compensation provided that certain requirements are satisfied, including (among others) that the advisers do not systematically favor the clients from whom they receive performance-based compensation. The fact that investment advisers include discussions regarding the potential conflicts of interest created by their practice of charging performance-based fees does not mean that the investment advisers are breaching their fiduciary duties or otherwise engaging in inappropriate conduct. By permitting performance fees under the Advisers Act, Congress and the Commission have recognized that performance fees are an appropriate form of compensation for certain types of clients. Investment advisers have the ability to implement appropriate policies, procedures and monitoring to adequately address potential conflicts of interest that may arise because the investment advisers charge performance fees.

11 "Impersonal advisory services" would be defined in the proposed amendments to Rule 204-3 to include "investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts."

12 "Qualified purchasers," as defined under Section 2(a)(51)(A) of the 1940 Act 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.

13 *See* Letter from Jay S. Neuman, Corporate Counsel, Federated Investors, Inc. to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, June 13, 2000 ("Federated's 2000 Comment Letter").

Like registered investment companies, such institutional clients are sophisticated investors that are capable of evaluating investment advisers without receiving mandatory disclosures. While not subject to Section 15(c), such institutional clients independently receive information that would be included in the proposed brochure through "requests for proposal" ("RFPs"). Through the RFP process, these institutional clients receive information about investment advisers that such clients have decided is important to them. In most cases, these institutional clients also require responses to be provided in a particular order or format, so they get the information that is important to them in an order and format that allows them to compare the responses they receive from the various investment advisers that are asked to respond to the RFP. Requiring delivery of brochures to such institutional clients would be duplicative and, in many respects, less meaningful and useful for these institutional clients. Please refer to Federated's 2000 Comment Letter for a further explanation as to why Federated believes the Commission should adopt an additional exception to the initial delivery requirements for these types of institutional clients. Moreover, as the Commission noted in the Proposed Amendments, even absent an express delivery requirement, an investment adviser would have a fiduciary obligation to disclose material information affecting the advisory relationship.

### B. Brochure Supplements Should Not Be Required To Be Delivered For Sales Representatives Who Are "Supervised Persons" Of An Investment Adviser

With respect to initial delivery of brochure supplements, the Proposed Amendments would require that "a client be given a brochure supplement for each supervised person who (i) formulates investment advice for that client and has direct client contact, or (ii) makes discretionary investment decisions for that client's assets, even if the supervised person has no direct client contact." In the Proposed Amendments, the Commission eliminated from its 2000 Proposed Amendments a provision requiring delivery of brochure supplements for supervised persons who merely communicate investment advice. In the Proposed Amendments, the Commission limited the brochure supplement delivery requirement in this manner because client service representatives who transmit investment advice to clients have no influence on the advice given; thus, "a particular client would receive disclosure specifically about those persons on whom he relies for investment advice."

Federated urges the Commission to confirm or clarify that sales representatives who are "supervised persons" because they "provide advice on behalf of the adviser" are excluded from the brochure supplement delivery requirements.[14] While these sales representatives may communicate investment advice through the distribution of marketing materials, these sales representatives also may meet with clients, discuss available investment strategies and other investment products with clients, and discuss recent account activity, portfolio transactions, and performance. These latter activities cause these sales representatives to be considered "as providing investment advice" on behalf of an investment adviser (not merely communicating investment advice). These sales representatives, however, are not

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14 Section 202(a)(25) of the Advisers Act defines "supervised person" to mean "any partner, officer, director (or other person occupying a similar status or performing similar functions), or employee of an investment adviser, or other person who provides investment advice on behalf of the investment adviser and is subject to the supervision and control of the investment adviser."

portfolio managers, do not formulate the investment advisers' investment advice relating to the implementation of investment strategies and security selection and do not have discretionary authority over client assets. These sales representatives do not influence the investment advice that is formulated on behalf of clients. Moreover, similar to third-party solicitors for which brochure supplements do not have to be delivered because they are required to provide a separate disclosure statement under Rule 206(4)-3(a)(2)(iii)(A)(3), these sales representatives would make the disclosures regarding their status and affiliation with the investment adviser as required under Rule 206(4)-3(a)(2)(ii). The provision of brochure supplements regarding such sales representatives would not be meaningful disclosure for clients. Providing brochure supplements for such sales representatives also would impose unnecessary costs on, and be administratively burdensome for, larger advisory organizations with large sales forces.

### C. Brochure Supplements Should Not Be Required To Be Delivered For Portfolio Management Team Members Who Have Client Contact

Instruction 1 to proposed Part 2B of Form ADV would provide: "No supplement is required for a supervised person who has no direct client contact and has discretionary authority over a client's assets only as part of a team." In the Proposed Amendments, the Commission indicated its belief that "when investment advice is formulated by a team, specific information about each individual team member takes on less importance." Federated agrees with the Commission's position. Federated, however, believes this position should remain the case even if members of the team have contact with clients, whether as part of an initial client meeting, when responding to a client question or otherwise. One must assume that at some point clients would desire some contact with the portfolio management staff advising their accounts. Moreover, Rule 3a-4 under the 1940 Act requires that personnel of investment advisers who are knowledgeable about client accounts and their management be reasonably available to the client for consultation. A single, or different, team member may be made available to clients from time to time to satisfy this requirement. The retention of a "no client contact" requirement would render this "team exception" useless as a practical matter. Moreover, where investment advisers' advice is formulated by a team, such as, for example, in the case of an investment adviser that utilizes quantitative investment models developed by a team, the fact that one or more of them may have contact with clients does not make specific information about the individual team member more important. Providing a brochure supplement regarding a member of a team who has contact with clients would not be providing clients with meaningful disclosure regarding the team (or the quantitative models developed by the team) on which the clients are relying to provide investment advice.

### D. The Proposed Amendments Afford The Commission The Opportunity To Clarify Certain Initial Delivery Requirements With Respect To Wrap Fee And Other Investment Programs

The Proposed Amendments would amend Rule 204-3 to require that "you (or a supervised person acting on your behalf)" must deliver a current firm brochure before or at the time it enters into an advisory contract with a client. Instruction 8 to proposed Part 2A of Form ADV would instruct investment advisers that provide portfolio management services to clients in wrap fee programs that "you must deliver your firm brochure to your wrap fee clients" and that "[y]ou also must deliver to these clients any brochure supplements required by Part 2B of Form ADV." Federated believes the proposed changes to Rule 204-3, and Instruction 8 to proposed Part 2A, provide the opportunity for the

Commission to provide useful guidance to sponsors of, and investment advisers that participate in, wrap fee and other investment programs[15] regarding the delivery of an investment advisers' brochure and brochure supplements to clients obtained through such programs.

### 1. Proposed Rule 204-3 Needs To Permit Program Sponsors To Deliver Mandatory Disclosures For Investment Advisers

It is a common practice in the industry for sponsors of wrap fee and other investment programs to agree to provide to clients the mandatory disclosures of the investment advisers that participate in their programs. In National Regulatory Services, Inc., [16] the Commission's Staff indicated that investment advisers could delegate the delivery of their mandatory disclosures to sponsors of programs. In Federated's experience, it is a common practice in the industry for the required disclosures of investment advisers that participate in such programs to be provided by the sponsors of such programs to clients prior to the investment advisers commencing management of the clients' assets. Since sponsors of such programs typically would not be "supervised persons" of the investment advisers that participate in their programs, Federated urges the Commission to clarify that the references to "you (or a supervised person acting on your behalf)" in the proposed amendments to Rule 204-3(b), and Instruction 8 to Part 2A of Form ADV, are not intended to supersede the position of the Staff in the NRS Letter with respect to the ability of investment advisers to delegate the delivery of their mandatory disclosures to sponsors of programs.

### 2. Confirmation/Clarification Should Be Provided Regarding The Ability Of Sponsors To Maintain Required Records For Investment Advisers

Federated also believes the Proposed Amendments afford the Commission the opportunity to confirm whether sponsors of wrap fee or other investment programs may create and retain records relating to the delivery of investment advisers' mandatory disclosures. In the NRS Letter, the Commission's Staff indicated that sponsors may create the records required under Rule 204-2, but that, in order to comply with the requirement in Rule 204-2 that require records be maintained for the first two years "in an appropriate office of the investment adviser" ("Appropriate Office Requirement"), the records should be transferred to the investment advisers for maintenance.[17] In 2005, in response to a no-action request from the American Bar Association concerning various topics relating to "private funds," the Staff indicated that it would not recommend enforcement action to the Commission under Section 204 or Rule 204-2 against an investment adviser, or a third-party administrator, with respect to the Appropriate Office Requirement, provided that: "(i) the Administrator acts as a service provider to the adviser in maintaining, preparing, organizing and/or updating the adviser's records for the adviser's

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15 By "other investment programs" Federated is referring to programs intended to satisfy the non-exclusive safe harbor from the definition of "investment company" under the 1940 Act set forth in Rule 3a-4 under the 1940 Act, whether or not the program technically satisfies the definition of "wrap fee program" in Rule 204-3(g)(4) under the Advisers Act.

16 National Regulatory Services, Inc., SEC No-Action Letter (pub. avail. Dec. 2, 1992) ("NRS Letter").

17 *See Id.*

ongoing use in its business, and does not merely provide long-term storage of the records; and (ii) upon request of the Commission's staff, the records are produced promptly for the staff at the appropriate office of the adviser or an office of the Administrator."[18] The Staff went on to indicate in a footnote that: "Our position in NRS is superseded insofar as it is inconsistent with this response."[19] Given the Staff's position in the American Bar Association no-action letter, Federated urges the Commission to confirm that sponsors of wrap fee or other investment programs may create and retain records relating to the delivery of investment advisers' mandatory disclosures so long as sponsors agree to produce the records promptly.

If the Commission is not willing to confirm the above position, or in the absence of such an agreement by a sponsor, Federated urges the Commission to clarify that investment advisers would satisfy their recordkeeping obligations under Rule 204-2 with respect to the delivery of mandatory disclosures by (1) requesting annual certifications from sponsors as to the delivery of the investment advisers' disclosure documents or (2) otherwise annually requesting sponsors to confirm lists of clients that received the investment advisers' disclosure documents and the dates by which the disclosure documents were provided. In Federated's experience, while sponsors usually accommodate requests for access to such records if required to satisfy regulatory requirements (including requests from the Staff), certain sponsors may be reluctant to provide such access or provide copies of their records to investment advisers due to operational, cost or other concerns. Federated believes this approach strikes a reasonable balance between the investment advisers' need to ensure that sponsors are fulfilling their delivery obligations, the investment advisers' need to maintain records evidencing delivery of their required disclosure documents, the clients' need to obtain relevant disclosures, and the sponsors' desire to streamline the operational requirements for, and costs of, their programs.

### 3. Confirmation/Clarification Should Be Provided Regarding The Client Delivery Requirements Where The Sponsor Is A Financial Institution

Investment advisers sometimes participate in wrap fee or other investment programs in which the sponsors are financial institutions (*e.g.*, banks) that have discretion, as trustee or investment agent or in another fiduciary capacity, over the investment of their customers' assets. In Federated's experience, these financial institutions often take the position, based on trust and banking law, that, because their customer did not retain discretionary investment authority, the investment advisers' disclosure documents are only required to be delivered to the financial institution, and that the financial institution may offer, but is not required to deliver, the investment advisers' disclosure documents to the financial institutions' customers (for example, a beneficiary of a trust account where the bank is the discretionary trustee). Federated believes that confirmation by the Commission that investment advisers may treat such financial institutions (and not their customers) as their clients for purposes of the disclosure delivery requirements under Rule 204-3, or a clarification regarding this practice in Instruction 8 to Part 2A of Form ADV, would be appropriate and useful.

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18 *See* American Bar Ass'n, SEC No-Action Letter (pub. avail. Dec. 8, 2005).

19 *See Id.*, n.51.

#### 4. Confirmation/Clarification Should Be Provided Regarding The Client Delivery Requirements For Model Portfolio Management Programs

In the Proposed Amendments, the Commission recognized that wrap fee programs have begun to transition to model portfolio-based programs. In Federated's experience, investment advisers that participate in these programs generally provide investment recommendations to third-party overlay managers by providing them with model portfolios and periodic updates to such model portfolios. While overlay managers may specify certain requirements for the model portfolios, the investment advisers' recommendations generally are not based on the objectives or needs of any individual clients of the overlay manager. The overlay managers, not the investment advisers, have investment discretion with respect to the management of the overlay managers' clients' assets. In these types of programs, overlay managers are free to accept or reject investment advisers' recommendations, may create strategies using multiple model portfolios received from multiple investment advisers, and generally retain all suitability, trading, proxy voting, and other responsibilities with respect to client accounts. The investment advisers have no direct relationship with the overlay managers' clients. While some overlay managers may provide investment advisers' disclosure documents to clients of the overlay manager from time to time, in Federated's experience, it is not common in the industry for investment advisers' disclosure documents to be provided to the clients of overlay managers in model portfolio-based programs. Federated believes that confirmation by the Commission that investment advisers may treat the overlay managers (and not the overlay managers' clients) as their clients for purposes of disclosure delivery requirements in Rule 204-3, or a clarification regarding this practice in Instruction 8 to Part 2A of Form ADV, would be appropriate and useful.

## III. Proposed Annual Delivery Requirements

### A. Annual Delivery To "Qualified Purchaser" Clients Is Unnecessary

The Proposed Amendments would require investment advisers to deliver their current brochures to existing clients at least once each year no later than 120 days after the end of the investment advisers' fiscal year. For the same reasons discussed in Section II.A above, Federated believes that annual delivery of the brochure to institutional clients that are "qualified purchasers" for purposes of Section 3(c)(7) under the 1940 Act is unnecessary, imposes unnecessary costs on investment advisers and is overly burdensome. Like registered investment companies, such clients are sophisticated investors that are capable of evaluating investment advisers without receiving mandatory disclosures, and are capable of requesting copies of their investment advisers' brochures if the institutional clients desire updated information.

If the Commission does not adopt an exception to the annual delivery requirements for "qualified purchaser" clients, Federated believes the Commission should either retain the current annual offer requirement for such institutional clients or, as an alternative, adopt a layered approach to disclosure by requiring that investment advisers provide such clients with an annual notice containing a concise summary of material changes to the investment advisers' brochure and a reminder that a complete copy of the brochure is available on an Internet Web site or upon request. Investment advisers already have processes in place for the annual offer requirement that could be maintained or modified to accommodate the notice requirement described above. Thus, Federated does not believe that either

retaining the annual offer requirement, or adopting the annual notice requirement described above, with respect to such institutional clients would significantly increase the burden on investment advisers. The institutional clients also would be able to obtain current copies of the brochures of their investment advisers if they want them.

### B. Annual Delivery Of Investment Adviser Brochures To Clients Of Wrap Fee Or Other Investment Programs Does Not Promote Meaningful Disclosure

The Proposed Amendments also would require investment advisers that participate in wrap fee or other investment programs to deliver their current brochures to existing clients at least once each year no later than 120 days after the end of the investment advisers' fiscal year. The Proposed Amendments also would require sponsors of wrap fee programs to provide copies of their wrap fee program brochure to clients at least once each year no later than 120 days after the end of the sponsors' fiscal year.[20] In most wrap fee or other investment programs, a specific client's assets may be allocated among multiple managers. Thus, under the Proposed Amendments, in addition to receiving initial disclosure documents for the sponsor and each investment adviser, each year such a client would receive a disclosure document from the sponsor of the program, as well as the brochure of each investment adviser that is responsible for managing some portion of the client's assets. Federated does not believe providing such a client with all these disclosure documents on an annual basis is an effective method of providing meaningful disclosure to such a client.

Federated also believes that a requirement that investment advisers annually deliver their brochures to clients of wrap fee and other investment programs, which may number in excess of 10,000 clients, imposes unnecessary costs on, and is overly burdensome for, investment advisers that participate in such programs. Because sponsors also often charge investment advisers for the costs of delivering mandatory disclosures to clients, an annual delivery of a complete brochure will likely significantly increase the costs of participating in such programs for investment advisers.

Sponsors of such programs often conduct due diligence on the investment advisers that participate in such programs, both initially and periodically (typically quarterly), require the investment advisers to update them on material events that effect their businesses, and often update manager profiles at least annually. Most sponsors also monitor investment advisers for compliance with the sponsors' requirements for participation in their programs, and will remove unqualified investment advisers from their programs. The sponsors also generally assist clients with the selection of investment advisers, and structure their programs as to maintain primary responsibility for client communications and contact. Given the oversight provided by sponsors of such programs, Federated believes that the annual offer requirement for clients of wrap fee or other investment programs strikes the appropriate balance between affording clients the opportunity to obtain additional information about investment

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20 In Federated's experience, sponsors of investment programs (which are not "wrap fee programs") that may not be required to provide a wrap fee program brochure to clients nevertheless generally provide clients with disclosures regarding their programs. With respect to such non-wrap fee programs, Federated's comments are limited to those in which the sponsor provides separate, detailed program disclosures similar to those required to be provided in the wrap fee program brochure of a sponsor of a wrap fee program.

advisers, affording clients the opportunity to have access to a large number of investment advisers through such programs and the costs to investment advisers of participating in such programs.

If the Commission does not elect to retain the annual offer requirement, Federated believes the Commission should adopt a layered approach to disclosure by requiring that sponsors of such programs include, either in or with their wrap fee program brochure, or other disclosure documents, a notice containing a concise summary of material changes to each applicable investment advisers' brochure and a reminder that a complete copy of the brochure is available on an Internet Web site or upon request. Such a requirement should not be materially more costly or administratively burdensome on sponsors because sponsors generally require investment advisers to provide them with updated disclosure documents at least annually, and the Proposed Amendments already contain a requirement for investment advisers to prepare the concise summary of material changes, which the sponsors could then include in such notices. Clients would then receive an updated disclosure document annually from the sponsor, which would contain disclosures concerning the overall program through which the clients' assets are being invested. Clients also would receive material information regarding the investment advisers that are responsible for managing their assets in a more meaningful manner and would be able to obtain current copies of the brochures of their investment advisers if they want them.

## IV. Specific Disclosure Items

### A. Disclosure Of Amounts Or Ranges Of Mutual Fund Fees And Other Third-Party Fees Would Be Duplicative

Proposed Item 5 of Part 2A of Form ADV would require investment advisers to disclose in their brochures that clients will incur brokerage and other transaction costs and whether clients will incur mutual fund or other third-party fees. The Commission did not propose that investment advisers disclose the amount or range of mutual fund fees or other third-party fees that clients may pay. Federated believes the Commission's approach is appropriate because, for example, mutual fund expense information is set forth in mutual fund prospectuses and, therefore, the amount or range of mutual fund fees does not need to be repeated in the brochures of investment advisers.

### B. Specific Risk Disclosure By Investment Advisers Offering A Variety Of Advisory Services Would Not Promote Meaningful Disclosure

Proposed Item 8 of Part 2A of Form ADV would require investment advisers to discuss in their brochures the risks clients face in following the investment advisers' advice or permitting the investment advisers to manage the clients' assets. In the Proposed Amendments, the Commission took the position that investment advisers that offer a wide variety of advisory services could simply explain that investing in securities involves a risk of loss, and that investment advisers that use primarily a particular method of analysis, strategy, or type of security would be required to explain the specific material risks involved, with more detail if those risks are significant or unusual. Federated agrees with the Commission's approach of not requiring multi-strategy advisers to disclose specific risks associated with each strategy in their brochures. Multi-strategy advisers already disclose the risks associated with their strategies to clients through means other than their Form ADV disclosures. The disclosure of risk information for each strategy would lengthen the brochure unnecessarily, and would make the brochure

less meaningful to clients by requiring information that may not be relevant to all clients. Disclosure of strategy-specific risks is better left for client-specific communications and client meetings.

### C. Proposed Disclosure Regarding The Effect Of Frequent Trading On Investment Performance Is Not Workable In An Investment Advisory Context

Proposed Item 8 of Part 2A of Form ADV also would require specific disclosure of how strategies involving frequent trading can affect investment performance. The Commission did not propose a definition of "frequent trading," but instead proposed to permit investment advisers to have some flexibility in determining whether the strategies they employ involve frequent trading. The Commission stated that it is concerned that a definition of the term "frequent trading" may not be sufficiently flexible to accommodate different types of securities or the different types of advisory clients.

Federated disagrees with the approach taken by the Commission with respect to disclosure regarding frequent trading. Federated believes that the concept of "frequent trading" is not easily defined in the context of investment advisers' management of client assets, and that the requirement for specific disclosure in investment advisers' brochures will increase the length of the brochures, make the brochures more legalistic, not provide meaningful disclosure and render investment advisers open to second guessing as to whether they should have made additional disclosure regarding "frequent trading."

While similar disclosure currently is required pursuant to Instruction 7 to Item 4(b)(1) of Form N-1A and Item 11(e) of Form N-1A, Instruction 4(a) to Item 8 of Form N-1A prescribes a methodology for calculating portfolio turnover rates for mutual funds. Such disclosure and methodology generally requires an investment adviser to evaluate portfolio turnover resulting from a specific mutual fund's investment strategy over the fiscal year of the fund. Unlike an investment strategy implemented with respect to a specific mutual fund, an investment adviser that manages institutional (non-mutual fund) assets and/or wrap fee or other retail assets is often implementing the same or similar strategies for multiple clients. Clients may impose differing investment restrictions on the management of their accounts. Additional client restrictions, adverse market conditions, or other circumstances unknown to investment advisers at the time they draft or update their brochures may arise that may increase portfolio turnover for a specific client or group of clients depending upon the applicable investment strategy.

In Federated's view, all of the above factors make specific disclosure of how strategies involving frequent trading can effect investment performance unworkable, would likely cause investment advisers to include lengthy, legalistic disclosure in their brochures, and would subject investment advisers to second guessing. The disclosure also would be less meaningful, particularly for clients of multi-strategy investment advisers to whom such disclosure may not be particularly relevant. In Federated's experience, expenses associated with portfolio turnover, and the possible impact on performance, are taken into account by portfolio managers, and weighed against the potential return from an investment, when portfolio managers are making decisions about whether or not to buy or sell a security for client accounts. Discussions regarding the effect of portfolio turnover are more meaningful if done on a client-by-client basis, either initially and/or periodically depending upon market conditions, client imposed investment restrictions and other factors. Federated believes that disclosure of the effects of

portfolio turnover is another disclosure that is better left for client specific communications and client meetings.

### D. Disclosure For Ten Years Should Not Be Required In The Brochure Or Brochure Supplement For Every "Disciplinary Event"

Proposed Item 9 of Part 2A and Item 3 of Part 2B of Form ADV would require that investment advisers disclose if they (or any of their management persons), in the case of the brochure, or any of their supervised persons, in the case of the brochure supplement, have been involved in certain disciplinary events. Specifically, investment advisers would be required to disclose material facts about any legal or disciplinary event that are material to clients' evaluation of the integrity of the investment advisers or their management, incorporating the disciplinary disclosure currently required by Rule 206(4)-4 under the Advisers Act. These proposed disclosure items would provide a list of disciplinary events that are presumptively material if they occurred within the previous 10 years. The list would include, among other events, any convictions for theft, fraud, bribery, perjury, forgery, and violations of securities laws by investment advisers and their management persons. Such events would be considered presumptively material to clients, although investment advisers would be permitted to rebut this presumption, in which case no disclosure to clients would be required. However, investment advisers rebutting a presumption of materiality would be required to document that determination in a memorandum and retain that record in order to better permit the Commission to monitor compliance with this requirement. The four factors investment advisers would need to consider when assessing whether the presumption can be rebutted include: (1) the proximity of the person involved in the disciplinary event to the advisory function; (2) the nature of the infraction that led to the disciplinary event; (3) the severity of the disciplinary sanction; and (4) the time elapsed since the date of the disciplinary event (which are the same factors as Rule 206(4)-4).

Federated agrees with the Commission that the nature, degree, and timing of disciplinary events, and the relationship of those disciplinary events to the advisory functions of investment advisers, are important factors in determining whether disclosure regarding disciplinary events would be meaningful to a client in evaluating the integrity of an investment adviser or its management. However, based on these considerations, Federated urges the Commission to revise these disclosure items to limit the disclosure of disciplinary events in the brochure or brochure supplement (as applicable) to a period of time less than ten years (*e.g.*, five years) if (1) the event does not involve a conviction, plea of guilty or plea of nolo contendre to (a) a felony, or (b) a misdemeanor in which an investment adviser or management person is found to have committed forgery, material misrepresentation, perjury, bribery, wrongful conversion of property, counterfeiting or extortion relating to investments or an investment-related business, or (c) a conspiracy to commit the foregoing offenses, or (2) the Commission, other federal regulatory agency, state regulatory agency, foreign financial regulatory authority or court agree in connection with a negotiated settlement that the nature, degree and relationship of the disciplinary event are such that disclosure would be required for a lesser period of time (*e.g.*, 5 years). Similar to the delivery of administrative orders to clients, the length of time during which an adviser would be required to disclose certain disciplinary events is a proper subject for negotiation during settlement discussions.

### E. The Definition Of "Involved" Should Be Limited To Terms With More Settled Meanings Under The Law

As noted above, Proposed Item 9 of Part 2A and Item 3 of Part 2B of Form ADV would require that investment advisers disclose if they (or any of their management persons), in the case of the brochure, or any of their supervised persons, in the case of the brochure supplement, have been involved in certain disciplinary events. "Involved" would be defined using the current Form ADV definition as: "engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act." Federated believes that the definition of the term "involved" should be shortened because it includes concepts, such as "counseling," "commanding," and "inducing" which may be ambiguous, overly broad and difficult to apply depending upon the circumstances. Federated proposes limiting the definition to concepts that have more settled meanings under the law. Federated also suggests that the Commission consider revising the definition of "involved" to include an element of due process. Federated proposes that the definition of "involved" be changed to read: "admitting or being found to have been directly engaging in (whether by act or omission), aiding, abetting, conspiring with or failing reasonably to supervise another in doing an act."

### F. Investment Advisers Should Not Be Required By Rule To Deliver Administrative Orders To Clients

In the 2000 Proposed Amendments, the Commission had proposed requiring investment advisers subject to a Commission administrative order to provide clients with a copy of that order. The Commission is not currently proposing this requirement, but still requested comment as to whether delivery should be required of all or some of a specific category of administrative orders. Federated does not believe that delivery of any category of administrative orders would benefit clients. Administrative orders are often lengthy and the subject of negotiated settlements between investment advisers and regulators. Disclosure of disciplinary events will be adequately addressed in proposed Item 9 of Part 2A and Item 3 of Part 2B of Form ADV. If the Commission believes a particular investment adviser should be required to disclose a particular administrative order to its clients, that requirement is a proper subject for negotiation during settlement discussions.[21]

### G. Investment Advisers Should Not Be Required To Disclose Arbitration Awards Or Civil Damages

While the Commission did not propose requiring disclosure of arbitration awards in the Proposed Amendments, the Commission did request comment about whether disclosure of certain arbitration claims or awards, or civil damages, should be required. Federated does not believe disclosure of arbitration claims, settlements or awards, or civil damages arising from private litigation, should be required. Such proceedings, and the amounts involved in such proceedings, may have nothing to do

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21 Even if the Commission negotiates for disclosure of administrative orders to clients during settlement negotiations with investment advisers, Federated believes that requiring investment advisers to provide summaries of such administrative orders, which contain language advising clients that complete copies of any such administrative orders are available on an Internet Web site, would provide more meaningful disclosure to clients.

with the integrity of investment advisers.[22] Regarding claims, investment advisers may be subject to strike suits and other unsubstantiated claims. Regarding settlements, investment advisers may be willing to settle claims to avoid incurring additional costs in defending an action, even where the investment advisers do not believe they are liable. Regarding awards, arbitrators sometimes "split the baby" rather than appropriately apportioning liability. In addition, the disclosure of claims, settlements, awards or damages over a certain threshold would not be meaningful because, for example, a $50,000 award may be material to small investment advisers but would be immaterial to larger investment advisers. The disclosure of the impact of such claims, settlements, awards or damages on investments advisers is currently, and would continue to be, adequately addressed through the requirement that investment advisers disclose financial conditions, or legal events, that impair or are material to an advisers' ability to meet its contractual commitments to clients.

## V. The Commission's Cost-Benefit Analysis

In the Proposed Amendments, the Commission estimated that, on average, investment advisers would spend 22.25 hours to complete the proposed revised Form ADV, an additional 7.42 hours per year thereafter to update Form ADV, and an additional 0.75 hours per year preparing Form ADV amendments. The Commission estimated investment advisers would spend approximately $56 per hour. The Commission based these estimates principally on the size of investment advisers registered through the Investment Adviser Registration Depository. The Commission also estimated that small advisers would spend $1,200, medium-size advisers would spend $4,400, and large advisers would spend $10,400, respectively, on outside legal counsel fees to complete the revised Form ADV.

Federated believes that the Commission's time estimates understate the burden imposed by the Proposed Amendments, particularly with respect to organizations, like Federated, that have multiple investment advisers that are engaged in multiple lines of advisory business and offer multiple investment strategies and other investment products to clients. The burden is further exacerbated if the organization has affiliated broker-dealers or other financial industry affiliations. Given the proposed disclosure regarding conflicts of interest, and the other proposed disclosure requirements, these investment advisers will spend exponentially more time and resources preparing the initial revised Form ADV, preparing amendments and preparing annual updates.

Federated's comment on the Commission's time estimates is based on Federated's most recent experience with updating the Form ADV disclosures for its seven investment advisory subsidiaries that are registered with the Commission under the Advisers Act. The compliance manager at Federated responsible for the review and annual updating of the Form ADV disclosures spent, on average, approximately 45 hours per Form ADV. This time estimate does not include time spent by others in Federated's Compliance Department or business lines, or Federated's outside counsel, who assisted the lead compliance manager with completing the annual updates.

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22 Federated's comment is consistent with the ICI Comment Letter regarding the questionable usefulness of this information.

The Commission also estimated that, on average, investment advisers would spend 279 hours per year to distribute their brochures and any updates annually to clients. The Commission estimated investment advisers would spend approximately $56 per hour. The Commission based these estimates on the average number of clients for investment advisers.

Federated believes that the Commission's cost estimates understate the burden on investment advisers. The costs of initial and annual delivery of complete mandatory disclosures to clients will be greater in larger advisory organizations. The costs also will increase substantially for investment advisers that participate in multiple wrap fee and other investment programs through which the investment advisers could manage assets for 10,000 or more clients. This could include investment advisers of any size. For example, Federated received an estimate of $29,425 for printing and mailing 10,000 copies of one of its advisory subsidiary's Form ADV, Part II to wrap account clients. Sponsors of such programs will likely charge the costs of delivering the investment advisers' brochures, brochure supplements, annual brochure updates and any required amendments back to the portfolio managers.

**Conclusion**

In conclusion, Federated urges the Commission to adopt Federated's recommendations regarding the format, initial and annual delivery and other requirements discussed in this letter. Federated believes its recommendations will result in more meaningful disclosure being provided to clients of investment advisers in a manner that is less costly and administratively burdensome overall on investment advisers.

Federated very much appreciates having the opportunity to comment on these important Proposed Amendments. If you would like to discuss these comments or any other aspects of the Proposed Amendments, please contact George Magera by phone at 412-288-7268 or by email at gmagera@reedsmith.com.

Very truly yours,

George F. Magera

GFM:sd

cc: Peter J. Germain, Esq.