CFA INSTITUTE | Centre for Financial Market Integrity

22 May 2008

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

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

Dear Ms. Morris:

The CFA Institute Centre for Financial Market Integrity[1] is pleased to comment on the SEC's proposed amendments to Form ADV. As the registration document for investment advisers, this serves the important function of making publicly available to clients a range of meaningful information.

We strongly support the majority of these amendments. In particular, a number of the proposed revisions focus on arrangements that may present conflicts of interest between the adviser and its clients, and require the adviser to address how those conflicts will be resolved. We think this is a very positive development and the appropriate approach in a document that is used, in part, to provide clients with the most direct information on the firm and its personnel handling the advisory accounts. It is the addressing of these conflicts that provides the client with invaluable insight into the adviser's philosophy toward client accounts.

Background

We have been actively interested in revisions to Form ADV for more than ten years. In fact, we first voiced support for a number of the proposals being presented here in early 1998, prior to a formal proposal from the SEC but following a meeting with SEC staff. [2] These recommendations included the delivery of a "plain English" narrative brochure to clients that would provide more meaningful information and would require updating only if the information became materially inaccurate, or otherwise on an annual basis.

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[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 95,300 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries of whom more than 82,300 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

[2] See January 21, 1998 letter from Linda L. Rittenhouse of then-Association of Investment Management and Research (AIMR) to Robert E. Plaze of the U.S. Securities and Exchange Commission.

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As staff continued efforts to release a revised Form ADV proposal for public comment, we provided additional comments.[3] When the SEC released its 2000 proposal, we welcomed many of the revisions proposed for Form ADV.[4] We are pleased that the current proposal contains many of the revisions originally proposed in 2000. Comments on these and additional amendments are provided below.

Comments

Proposed Format

In keeping with positions stated in prior letters, we support use of a narrative brochure written in plain English that is filed electronically through the Investment Adviser Registration Depository. We continue to believe that this flexibility will allow advisers to present information related to its business practices in a way that best informs the investor.

Brochure Items

The 2000 proposal would have required advisers that advertise or report their investment performance to describe standards they use to calculate or present their performance. The SEC staff has decided not to repurpose this item, citing a number of organizations' objections. We urge reconsideration of this.

We believe that investors are keenly interested in receiving information on how advisers calculate or present their performance. Investment return calculations can be manipulated and performance misrepresented when industry standards are not used. Thus, it is important for investors to know how these returns have been calculated. Moreover, presentation standards for investment performance are recognized as an industry best practice throughout the world. Investment performance standards that are part of the Global Investment Performance Standards (GIPS®) enable investors to compare performance of one fund against that of another.

As proposed, advisers do not have to discuss their policies and procedures, but instead must explain how they address their conflicts of interest. This is supposed to give clients "a general understanding" of how they address conflicts. We appreciate this change as a targeted approach to describing the details of arrangements that have the potential to compromise client interests. We do recommend, however, that advisers be required to include a statement in their brochure that they will provide a copy of their policies and procedures upon request.

With respect to requested comments on whether advisers should repeat information that is responsive to more than one item, we agree with the proposal that repetitive information is not necessary. As long as the information is disclosed, the client has been put on notice. We suggest a simple reference to the previous location where the information can be found in response to an item.

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[3] See March 15, 1999 letter from Linda L. Rittenhouse of then-AIMR to Robert E. Plaze of the U.S. Securities and Exchange Commission.

[4] See June 13, 2000 letter from Deborah A. Lamb and Linda L. Rittenhouse of the Advocacy Advisory Committee of then-AIMR to Jonathan G. Katz of the U.S. Securities and Exchange Commission.

Comments on specific Part 2 items are provided below.

Item 1. Cover Page

We agree that if the adviser holds itself out as being "registered", the cover page should clarify that SEC registration does not imply a certain level of expertise. Given that the SEC has noted different expressions relating to this in some marketing materials, we suggest that the SEC provide standardized language advisers should use when addressing this status.

Item 2. Material Changes

We agree with the requirement that a summary of material changes since the last annual update be provided to clients, either on the cover page or in a separate communication accompanying the brochure. We suggest that advisers with websites also be required to post the information electronically.

Item 3. Table of Contents

The note to this item states that the order of information presented in the brochure going to clients does not have to follow the same order as the listing of Part 2 requirements. While we appreciate the flexibility to advisers, we suggest that an ordered approach has benefits for clients and the SEC.

Thus, we support use of a prototype table of contents so that investors can compare the information provided by all advisers more easily. While we understand there is a diversity of advisers' business practices, we believe a standardized approach to regulatory disclosure of the same information is important for consistency. Even if the specific topics vary greatly, standardized headings and ordering will allow the presentation of information in a way that investors can follow. If headings or sub-topics do not apply, advisers can simply indicate their non-applicability. We believe an approach that seeks to create a uniform format is preferable, for many of the same reasons offered in the SEC's recent proposal on use of a summary prospectus.

Item 4. Advisory Business

We support disclosure under this item that would require a description of the adviser's business and the types of services offered, and disclosures concerning whether the firm specializes in particular types of advisory services. We agree that advisers should provide disclosure on areas in which they hold themselves out as specializing in that many investors would be interest in receiving that information.

In assessing "assets under management", the proposal would allow an advisor to use a calculating methodology that differs from that used in Part 1 of Form ADV. We understand the rationale for allowing the use of two different methodologies, given the requirements for calculating "assets under management" under the National Securities Markets Improvement Act. We suggest, however, that the same methodology be used for calculation purposes in both parts and that disclosures to clients related to the nature of the adviser's business be provided with the calculation. This allows for consistency and eliminates the need for a requirement that advisers have to disclose why they have elected to use a different method of calculation.

Item 5. Fees and Compensation

We strongly support the requirement in this item that the adviser disclose that it received brokerage commissions for the sale of securities and/or other investment products to its clients, any conflicts this causes, and how the adviser addresses these conflicts. We particularly welcome Instruction 1 to Item 5 E that requires an affirmative statement that the receipt of compensation for the sale of securities or other investment products, including mutual fund "trail fees", presents a conflict of interest in that there is "an incentive to recommend investment products based on compensation received, rather than on a client's needs."

Similarly, we support the requirement that advisers disclose to clients that they may find a better price for securities or investment products from brokers not affiliated with the adviser. Finally, we think it unnecessary for advisers to disclose the amount or range of mutual fund or other third-party fees as long as investors are put on notice that they may have to bear these additional costs.

Item 6. Performance Fees and Side-by-Side Management

We believe that requiring advisers that manage accounts not charged a performance fee to disclose this fact is a positive step in alerting investors to possible conflicts that may arise from this fee structure. It is equally important that investors understand the adviser's approach to addressing those conflicts, as proposed.

Item 7. Types of Clients

We agree with this requirement that the brochure provide information about the types of advisory clients serviced by the firm and about the firm's account requirements.

Item 8. Methods of Analysis, Investment Strategies and Risk of Loss

Meaningful discussion of an adviser's methods of analysis and its investment strategies is key information for an investor who is assessing his "fit" with a particular style and is highly preferable to the check-the-box approach required by current Form ADV.

We believe disclosure that highlights the risks of following the adviser's advice or of having the adviser manage the client's assets is central to the adviser's fiduciary relationship with its client, especially where particular types of analysis, strategies or securities are used. We therefore strongly support requiring a full discussion of the possible effect on client interests to be included in Form ADV.

While we understand the position that requiring advisers who use a wide variety of advisory services may lead to a lengthy discussion, we do not agree with simply requiring advisers to "explain that investing in securities involves a risk of loss". Instead, we recommend that advisers who use a variety of services still be required to highlight or explain how and why certain of the services may be riskier than others. We believe that communication of the type of risk is important and can be provided without unduly contributing to the overall length of the brochure.

We agree that advisers should be afforded flexibility in deciding when they engage in frequent trading and that attempting to define this precisely is impractical. At a certain point, registrants must use their good faith effort in making this and other such determinations. However, they should have to disclose information about portfolio turnover and related costs.

What is important is that advisers feel it incumbent upon them to provide what a reasonable investor would want to know in order to make well-informed decisions, including those relating to a choice of advisers. Thus, we urge a focus on requiring advisers to address in their Form ADV the potential consequences of frequent trading, even if accompanied by a caveat that a particular adviser does not believe it is applicable to its current portfolio or style.

Item 9. Disciplinary Information

We agree that information about relevant disciplinary actions involving an adviser is just what a reasonable investor would want to know.

We agree with the proposed use of "involved" with respect to this item, in casting the net over those whose behavior must be reported. We do, however, question the slight departure in the definition of "involved" from that used in Rule 206(4)-4, and suggest adding the word "causing" to the definition used in connection with Form ADV. This seems particularly appropriate in light of the SEC's intent to rescind Rule 206(4)-4 upon adoption of this proposal.

In addition to the specific disclosures required in the proposal, we also suggest the relevancy of disciplinary proceedings brought by professional organizations relating to activities involving financial matters. For example, we believe that advisers should be required to disclose such findings of professional conduct violations by organizations like state or federal bars, accounting organizations, and to some extent, CFA Institute, to the same extent as required by self-regulatory organizations.[5]

The current proposal limits disclosure of events to those no older than 10 years ago. Instead, we believe that investors should receive disclosure of felonies such as extortion, larceny, and racketeering, regardless of when they occurred. While the instructions to Item 9 do state that disclosure of events that occurred more than 10 years ago is required if "the event is so serious that it remains currently material to a client's or prospective client's evaluation", we urge the Commission to provide specific examples of felonies that fall within this group.

Similarly, we believe that certain categories of arbitration awards, settlements, or claims could be relevant to an investor's evaluation of an adviser. We suggest that this group be narrowly defined to require disclosure of an adviser's background that is relevant to an adviser's competency or integrity. The actual amount of damages awarded may not, in itself, be dispositive. While actual damage awards in a particular case may be small, repetitive awards relating to the same behavior may be indicative of a propensity that is relevant for investors to know. We suggest that the Commission provide further guidance along these lines.

Item 10. Other Financial Industry Activities and Affiliations

We support the proposed addition to Form ADV that would require advisers to address how they manage their (or those of their managements persons) material relationships or arrangements with related financial industry participants. Similarly, recommendations by an adviser of other advisers would require disclosure of conflicts, compensation arrangements, or other business relationships between the advisers. We believe that both requirements address areas that are of interest to investors.

[5] See January 21, 1998 letter at page 6.

Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

We strongly agree with the proposed requirement that an adviser describe its code of ethics and offer to provide it to clients and prospective clients. We believe that an adviser's code of ethics is indicative of the firm's commitment to its fiduciary duties to its clients. We similarly support the proposed approaches to disclosing the conflicts and resolutions of conflicts pertaining to personal trading and participation or interest in client transactions.

Item 12. Brokerage Practices

Disclosure required by this item relates to some of the more important information that investors receive through Form ADV. To that end, we strongly support the proposed disclosure relating to soft dollar arrangements. We believe it is important for investors to know the potential conflicts of interest inherent in an adviser engaging in soft dollar arrangements relating to either proprietary or third-party research, and how those conflicts are managed.

We agree that the adviser should provide disclosure in the areas that are proposed. We do, however, suggest several additional areas we believe should be addressed.

We recommend that the adviser provide a reasonable estimate of the percentage of the dollar amount of its soft dollar arrangements compared to its total dollar amount of all brokerage commissions on a yearly basis. By receiving this information, an investor will be better able to assess the degree to which the adviser is engaging in soft dollar arrangements and assess the potential effect on the adviser's duty to seek best execution. This disclosure may also raise questions in the minds of clients about the degree to which their accounts may be "subsidizing" others.

In addition, while the adviser must disclose conflicts relating to use of an affiliated broker in directed brokerage transactions, no such disclosure is specifically called for in connection with soft dollar arrangements. We recommend adding this requirement.

Item 13. Review of Accounts

We strongly support the proposed disclosure regarding review of, and reports regarding, client accounts. We believe that persons serving in an advisory capacity owe a responsibility to clients to assess that client's financial needs and circumstances, and determine the suitability of investments. In order to do this, the adviser must gather a range of information about the client and should incorporate it into a written document.

Investors may not be aware of various industry practices or the importance of reviewing and updating their accounts. By highlighting the procedures and frequency of reviewing client accounts through the information called for by this item, investors are put on notice that this is an area that deserves attention. They also are then afforded a basis for comparing the practices among advisers.

The CFA Institute Standards of Professional Conduct note that inquiry into a client's needs and financial situation "should be repeated at least annually and prior to material changes to any specific investment recommendations or decisions on behalf of the client."

Item 14. Payment for Client Referrals

We support this item's proposed disclosure of payments for client referrals and the receipt of any benefits from a non-client for providing advisory services to clients. These areas involve practices that potentially raise conflicts of interest and thus could affect the treatment of client accounts.

Item 15. Custody

We believe the degree of proposed disclosure required by this item is appropriate.

Item 16. Investment Discretion

We believe that the proposed disclosure, along with the definition of "discretionary authority or discretionary basis", together achieve the appropriate disclosure balance.

Item 17. Voting Client Securities

In addition to the disclosure that tracks the requirements of Rule 206(4)-6, we support the requirement that the adviser provide information related to the use of third-party proxy voting services. We agree that investors should know whether their advisers have (or will accept) authority to vote proxies, do not have that authority, or delegate that authority to a third-party. The enhanced disclosure accompanying these statements fills out what clients can expect under each scenario. Particularly helpful is the discussion on conflicts of interest that might arise, and how the adviser intends to resolve them. We also strongly support required disclosure of how the adviser pays for third-party services, including whether soft dollars are involved.

Item 18. Financial Information

We generally support the disclosure requirements under this item.

Item 19. Index

In keeping with our comments above, we believe that a generally uniform approach to addressing the information required by Part 2 is an approach that better serves investors by allowing a more direct comparison among the practices of advisers. This would also eliminate the need for the proposed index that provides a road map for SEC review.

Part 2A Appendix 1: The Wrap Fee Program Brochure

We agree that advisers that sponsor wrap fee programs should prepare a specific and separate wrap fee program brochure, and particularly support the new disclosure requirements about related persons that are portfolio managers in the program. Investors deserve to be put on notice as to the conflicts of interest these arrangements present and how the adviser intends to address them.

Part 2A--Delivery of Brochure

We generally support the approach being proposed for requiring interim delivery of brochures to update information that has become stale. We agree that requiring updates when disciplinary information changes warrants this action, given its importance. We suggest that in addition to disciplinary information, changes in certain information being required under Item 18 should also trigger a need to deliver an updated brochure. Any changes that materially impair an adviser's ability to meet its contractual commitments to clients or that threaten its move into bankruptcy are events worthy of being noticed to clients.

Part 2B—The Brochure Supplement

We strongly support a requirement that advisers supplement their brochures with information on advisory personnel that provide clients with advice. While the idea of this brochure supplement has been met with some controversy, we continue to believe that information on the qualifications and background of those who influence clients in connection with their investments are as relevant, if not more relevant, than the information currently required by Part 2 on senior executives of the firm[6] that may have little or no direct contact with the client.

We agree that the focus on the ability to influence the investment decision is appropriate. Thus, we support the proposed scope of information to be provided—for each supervised person who formulates investment advice for the client and has direct client contact or who makes discretionary investment decisions for that client's assets, even if that person has no direct contact with the client.

Accordingly, we are in agreement with the four categories of clients for whom the brochure supplement would *not* be required: clients to whom an adviser is not required to deliver a firm brochure; clients who receive only impersonal investment advice; clients who are "qualified purchasers"; and certain "qualified clients" who also are officers, directors, employees and other persons related to the adviser.

Brochure Supplement Items

We generally support the substance of the proposed brochure supplement as addressing areas of interest to clients. Additional specific comments are provided below.

Item 3. Disciplinary Information

In keeping with our comments in 2000, we support the requirement that legal or disciplinary events material to a client's evaluation of the supervised person's integrity be disclosed, including suspension or revocation of that person's professional designation. We believe that such actions would be relevant to a client's considerations. We agree that the proposed modifications that would limit disclosure to actions that resulted from a violation of rules relating to professional conduct, or that involved a relinquishment of the designation in anticipation of suspension or revocation unrelated to the nonpayment of membership dues, are appropriate.

[6] See June 13, 2000 letter.

Item 4. Other Business Activities

We agree that clients should receive information relating to potential conflicts of interest created by a supervised person's participation in other business activities and support the proposed disclosure required under this item. We also support the modified approach that would require disclosure of that person's participation in other activities that consume a substantial amount of his time or that provide a substantial amount of income. The client is in the best position to decide the relevancy of that particular information to his or her own situation.

Item 6. Supervision

We believe that it is important for clients to have the ability to locate a person within the firm to which they can direct questions or voice concerns about their accounts. Thus, we support the requirements that the firm provide a name, title, and telephone number of the supervisor of the person engaging in the advisory activities with the client. We also support the requirement whereby the firm explains how it monitors the advice provided by this supervised person.

Conclusion

Many of the proposed changes to Form ADV will provide investors with information that not only alerts them to potential conflicts of interest faced by the adviser but also allows them to evaluate for themselves whether the conflicts are being satisfactorily resolved. This theme is an important step toward empowering the investor in his or her own investment decisions.

We appreciate the ability to participate in this process. If you have questions about any of the positions taken in this letter or would like additional information, please do not hesitate to contact Kurt Schacht at 212.756.7728 (kurt.schacht@cfainstitute.org) or Linda Rittenhouse at 434.951.5333 (linda.rittenhouse@cfainstitute.org).

Sincerely,

/s/ Kurt N. Schacht

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