

The Final Push for Part 2A of Form ADV and Pay-to-Play

Deborah Bielicke Eades

Joseph M. Mannon

Jennifer M. Goodman

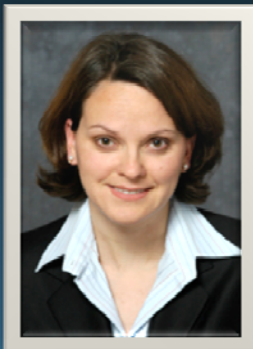
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Deborah Bielicke Eades



Shareholder
312-609-7661
deades@vedderprice.com

Deborah Bielicke Eades joined Vedder Price P.C. as a shareholder and is a member of the firm's Investment Services Group.

Ms. Eades has extensive experience in all aspects of mutual fund and investment adviser regulation and compliance, including product design, federal and state registration, representation of fund boards, portfolio compliance, derivative instruments, affiliated transactions, electronic commerce and Web site design, privacy matters and general regulatory matters.

Prior to joining Vedder Price, she was employed by Janus Capital Corporation in Denver as Associate Counsel and Assistant Vice President. She has participated on various industry committees including the Investment Company Institute's Rules Committee and Electronic Commerce Working Group. Ms. Eades regularly speaks at industry conferences on mutual fund, investment adviser and hedge fund regulation.

Ms. Eades is a member of the American Bar Association and the Chicago Bar Association, for which she formerly served as the Chair of the Investment Company Subcommittee. Ms. Eades is a member of the CFA Institute.

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Joseph M. Mannon



Of Counsel
312-609-7883
jmannon@vedderprice.com

Joseph M. Mannon is a member of Vedder Price P.C.'s Investment Services Group.

Mr. Mannon focuses his practice on legal and compliance matters for hedge funds, hedge funds of funds, investment advisors, mutual funds and other investment entities.

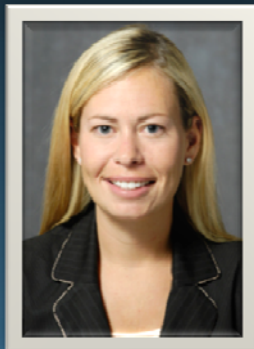
Prior to joining the firm, Mr. Mannon served as a Staff Attorney for the Division of Enforcement of the Securities and Exchange Commission from 2001 to 2004. At the Commission, he litigated federal district court actions and conducted numerous investigations, including complex financial fraud investigations. In addition, Mr. Mannon investigated mutual funds, investment advisers and broker-dealers for violations of the pricing, valuation and books and records requirements of the federal securities laws. Mr. Mannon was awarded the Securities and Exchange Commission Chairman's Award for Excellence in 2002.

In 2000, Mr. Mannon served as a judicial intern to the Honorable John W. Darrah, U.S. District Court for the Northern District of Illinois.

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Jennifer M. Goodman



Associate
312-609-7732
jgoodman@vedderprice.com

Jennifer M. Goodman joined Vedder Price P.C. as an associate in the Investment Services Group. Ms. Goodman focuses her practice on corporate and securities law with an emphasis on investment company and investment adviser matters.

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Part 2 – Introduction

- ✦ Focus on Content Requirements of Part 2A
 - Part 2B is not due until July and does not need to be filed via IARD
- ✦ This presentation is not intended to cover all Items in the new Part 2A
- ✦ Please consult the new Part 2A form for the disclosures required under each Item

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Part 2A – Compliance Deadlines

Existing Registrants	Deadline	Notes
Filing Part 2A via IARD	March 31, 2011	Assumes adviser FYE is December 31st
Deliver Part 2A to Existing Clients E-mail distribution is permissible	May 30, 2011 Each year thereafter, send Part 2A to clients within 120 days of FYE	Assumes adviser FYE is December 31st
Deliver Part 2B to New and Prospective Clients	July 31, 2011	Assumes FYE between December 31st and April 30th ¹
Deliver Part 2B to Existing Clients	September 30, 2011	Assumes FYE between December 31st and April 30th

New Registrants Between January 1st And April 30th	Deadline
Filing Part 2A via IARD	Upon Registration
Deliver Part 2A to Clients	Upon Registration
Deliver Part 2B to New and Prospective Clients	May 1, 2011 ²
Deliver Part 2B to Existing Clients	July 1, 2011

¹ Compliance dates for delivering Part 2B for an existing adviser with FYE after April 30th, 2011 has not changed.

² Compliance dates for delivering Part 2B for newly registered investment advisers filing applications for registration after April 30, 2011 have not changed.

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Format and General Drafting Tips

- ✦ Start from a Part 2A template
- ✦ Have marketing materials, website, firm DDQ, current product offering materials and your last year's Parts I and II of Form ADV at the ready
- ✦ **Watch out for inconsistent disclosure**
 - Good opportunity to clean up disclosure across the board
- ✦ Use conflicts/risk management committee agenda or meeting notes to help spot conflicts of interest
- ✦ Do not merely cut and paste from last year

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Item 1

- ✦ Item 1 – Cover Page
 - Full legal name of the adviser must be disclosed (Item 1.A)
 - ▶ DBA not sufficient
 - Make sure you include the required language on the cover page
 - No requirement to name a specific individual for questions about the brochure

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Item 2

◆ Item 2 – Material Changes

- For this year, recommend noting that the entire brochure should be considered materially updated
- For future updates, summarize material changes
 - ▶ Rule release references policies, practices and conflicts of interest
 - ▶ Keep the summary short
 - ▶ Don't need to repeat the change in its entirety

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Item 3

◆ Item 3 – Table of Contents

- Table of Contents needs to be in the same order as it appears in the form
- Some templates don't track the form, so double-check the table of contents
- Must respond to all Items
- Item 19 can be deleted for SEC registered advisers

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Item 4

◆ Item 4 – Advisory Business

- Sets the stage for Plain English
- Bucket advisory services into categories
- Check last year's Part II to make sure you cover all the advisory services offered by your firm
- Consider future services
- Executives that were listed in prior Part II can be listed here
- Discretionary and Non-Discretionary AUM numbers need to be rounded to the nearest \$100,000 and cannot be more than 90 days before the date of the filing
 - ▶ Keep documentation supporting AUM computation

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Item 5

◆ Item 5 – Fees and Compensation

- Various approaches to fee ranges
 - ▶ Suggest disclosing ranges by product lines
 - ▶ Balance disclosure with existing offering materials
- Description of other fees or expenses clients may pay in addition to advisers' services (i.e., custody, admin) (Item 5.C)
- Broker compensation and conflicts of interest in recommending investment products based on compensation received rather than client's needs (Item 5.E)
 - ▶ Example of conflicts disclosure mandated by the form
- Consider disclosing preferential fee terms from side letters and/or most favored nations provisions
- Catchall statement that fees are negotiable and may vary from general fee schedule

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Items 6 and 7

- ◆ Item 6 – Performance-Based Fees and Side-by-Side Management
 - If engaging in side-by-side management, disclosure of how the conflict is addressed is mandated by the form
 - ▶ Adviser will want to summarize trade allocation procedures to illustrate how it handles the conflict

- ◆ Item 7 – Types of Clients
 - Consider including catchall statement that minimums can be waived
 - Check the categories noted on last year's Part II

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Item 8

- ◆ Item 8 – Methods of Analysis, Investment Strategies and Risk of Loss
 - Consider putting Investment Strategies before Methods of Analysis
 - Consult your client's offering materials for risk factors to keep them consistent
 - Several approaches on risk factors
 - ▶ Kitchen sink
 - ▶ Disclose only primary risks
 - Focus on risk factors applicable to your services (e.g., manager of managers versus direct trading)

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Item 9

- ◆ Item 9 – Disciplinary Information
 - Items presumed material
 - ▶ Rebuttable presumption
 - Discuss with counsel whether legal or disciplinary events are material and require disclosure
 - Disciplinary information need only be disclosed about adviser and its management personnel and not all advisory affiliates

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Items 10 and 11

- ◆ Item 10 – Other Financial Industry Activities and Affiliations
 - To the extent your private funds are related persons because you are the general partner or managing member, you need to disclose that relationship
- ◆ Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading
 - Focus is on disclosure to identify and mitigate conflicts
 - ▶ Contemporaneous trading
 - Employee investments
 - Related party investments (i.e., proprietary hedge fund)

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Items 12 and 14

◆ Item 12 – Brokerage Practices

- Directed Brokerage
 - ▶ If advisers direct clients to execute transactions through a specific broker, disclose the practice or policy and any economic relationship with the broker that creates a conflict
- Trade aggregation
 - ▶ Discuss circumstances where trades will be aggregated
 - ▶ Disclose if you don't aggregate where you have the opportunity to do so along with the costs to clients of not aggregating

◆ Item 14 – Client Referrals and Other Compensation

- Aside from required solicitor disclosure, consider adding disclosure on other fees or revenue sharing arrangements between the adviser and a third party or affiliate

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Items 15 and 18

◆ Item 15 – Custody

- If you have custody, include disclosure encouraging clients to review statements and compare them to the account statements received from custodian

◆ Item 18 – Financial Information

- For advisers with discretion or custody, include required statement on whether there is any financial condition that is reasonably likely to impair the adviser's ability to meet its contractual commitment to clients

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Questions

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Pay-to-Play (Rule 206(4)-5)

- ✦ March 14, 2011 deadline for compliance
 - Political contributions prior to that time are not subject to two year “time out” or look back

- ✦ September 13, 2011 deadline
 - Stop third-party solicitation of government business except in compliance with Rule
 - Compliance date for covered registered investment companies

- ✦ Your policy will depend on your business model

- ✦ Consequences of violation
 - Two-year “time out” from receipt of compensation if Covered Associate makes a political contribution to government officer who is in a position to influence the selection of the adviser (subject to *de minimis* exceptions)

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Pay-to-Play

- ✦ Who should be a “Covered Associate”?
 - any executive officer, general partner or managing member
 - employees who perform policy-making functions
 - any employee who solicits a government entity and their supervisor
 - ▶ MSRB interpretations
 - Any PAC controlled by the adviser or any of its Covered Associates
- ✦ Creating categories in your procedure
 - Covered Associate
 - Restricted Person (likely to become a Covered Associate)
 - All Employees

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Pay-to-Play

- ✦ Look through for Pooled Vehicles
 - Private funds
 - Registered investment companies that are plan options (529, 403(b) and 457) for a government entity
- ✦ Impact of the look-back requirement
 - Most advisers applying pre-clearance to all employees to avoid issues down the road
 - HR Issues
 - ▶ When do you ask questions regarding a potential employee’s political contributions?
 - Pre-screen/Application
 - Interview
 - Contingent on the offer

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Pay-to-Play

- ✦ Extension to spouse and other family members?
 - Indirect contribution risk

- ✦ Political Action Committees (“PACs”)
 - Pose unique challenges
 - How are advisers dealing with them?
 - ▶ Outright ban
 - ▶ Federal only PACs
 - ▶ Require employees to get representation letters from PACs

- ✦ *De Minimis* Exceptions
 - \$350 versus \$150

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Pay-to-Play

- ✦ Resources
 - Personal Trading Software Provider
 - www.opensecrets.com
 - www.followthemoney.com

- ✦ Questions

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