From: Steven Thomas [redacted]
Sent: Wednesday, March 02, 2011 6:18 PM
To: Kenneth.Hojnacki@dfi.wisconsin.gov; Paul Schwartz; Kelvin Blake; David Smith; Hugo Mayer; Jackie Walter; dfinnigan@ilsos.net; Joseph Brady; derosiaL@michigan.gov
Subject: NASAA Proposed Model Rule Changes - Comment

Brochure Rule Comments
As you can imagine the new ADV 2 brochure(s) have been a huge item of concern – and some frustration – for many of our clients on the consulting side. I just did a webinar on Monday for our clients who have still not taken the bull by the horns and put together their new brochures. Of course no one ever waits till the last minute ☺. Another interesting item I noticed from the SEC's 174 page release was the they referred to attorney's and "plain English" in the same section – which I personally feel is an oxymoron (no offense – well maybe just a little to the attorneys in the crowd.) Many of the "encyclopedia like" filings I reviewed over the years came from law firms who tried to cover every possible contingency in 30-100 page ADV II filings. The requirement to only cover existing, current, or most probable conflicts of interest in the new filing should be a welcome change.

I applaud the changes you have made concerning the new brochures and only have one comment that I think should be considered by both the states and the SEC concerning the "Annual Delivery Requirement" provisions. In my personal experiences both as a former state regulator and now a consultant for RIA firms, the provision that allows firms to NOT file and annual amendment or deliver a summary of material changes to clients if no material changes have taken place "and the brochure is still materially accurate" (from the SEC) is a mistake in my opinion. While I understand the "pros" of this position: No duplicative paperwork, less expense, etc. My experience has shown me that if they are not required to do so, advisers by default will not file amendments or updates and will always claim that there has not been any real material changes in their business. My experience has also shown that his is a bunch of bunk!! Advisers are constantly "tweaking" their business models – adding third party advisers, or money managers, changing office locations, adding web sites, etc. etc. etc. While they don't see these items as "material" they certainly could be to a client's situation. Requiring them to take off the salesperson's hat and put on the CCO hat each year to update and review their filings is a healthy practice for every firm. In addition with the addition of the "Material Changes" page to the ADV 2A filing – regulators should not have to spend an inordinate amount of time reviewing annual filings. Another point here is that the majority or our clients are using electronic delivery methods (with signed client consent of course) for most if not all their client correspondence – so requiring and annual delivery would not be overly time or cost consuming.

One additional item of note is that I would your italicize comments for item (6) in the General Requirements section that a fee structure change should be consider "material" in nature. How much more material can it get to a client than to be made aware of a fee structure change on their accounts. Of course there are other ways advisers can and must inform their clients before changing the fee structure pertaining to their accounts but there at least should be some verbiage added somewhere about how a client would be informed of a fee change before it goes into effect. If it is not

required via ADV 2 update then how and where (what document) the client IS informed should be addressed.

Custody Rule Comments
My only comment here is that clarification of the custody "issue" as it applies to direct fee deduction only has been needed for years. In fact it was a frequent topic of conversation at the tables I used to moderate during IA Training. Many of our clients have been confused and received mixed messages from the various jurisdictions they are registered concerning whether direct fee deduction is considered custody and how it should be shown on their registration documents. As far as I have been able to tell, most jurisdictions list direct fee deduction in the "custody" section of their rules or statutes, but most jurisdictions (not all) have not required advisers to list this as custody on their ADV II (now 2) filings, and most if not all have exempted advisers from any additional B&R or bonding requirements if they only have direct fee deduction "custody". I remember using the term "limited custody" in the conversations that I had with various regulators over the years. While direct fee deduction remains the first question on the SEC ADV Part 1B, Item 2. I. CUSTODY – at least these rule changes should clarify how all states should deal with advisers that only have "custody" due to direct fee deduction of IA fees.

Steven J. Thomas
Director
Lexington Compliance