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May 16, 2008

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

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

Dear Secretary Morris:

This comment letter is submitted on behalf of National Regulatory Services, a division of SourceMedia, Inc. ("NRS"). NRS, located in Lakeville, Connecticut in 1983, is the nation's leading compliance consulting and registration services firm.

NRS offers compliance consulting and registration services and related products to investment advisers, broker-dealers, investment companies, hedge funds, insurance firms and other financial institutions. The NRS client base of over 5,000 domestic and international investment advisers, is comprised of a very wide range of advisory firms from sole proprietorships and start-up advisory firms to some of the largest global financial services organizations.

Over the years, thousands of NRS clients have used NRS' Form ADV software to complete, update and manage their registration forms. NRS is also a major compliance conference sponsor annually hosting several national conferences, as well as numerous live topical conferences and desktop seminars. In response to the adoption of the Compliance Programs Rule, NRS formed the NRS Center for Compliance Professionals. In alliance with the Investment Adviser Association ("IAA"), the Center for Compliance Professionals co-sponsors the Investment Adviser Compliance Certificate Program ("IACCP"), the first certificate program for investment adviser compliance professionals.

NRS commends the Division of Investment Management of the Securities and Exchange Commission (the "Commission") for the efforts put forth to craft the next phase of the comprehensive framework to complete the electronic filing system and final phase of the revision of Form ADV.

By amending Form ADV at this time, the Commission has a defining opportunity to modernize and craft the document into a meaningful resource for advisers, clients, regulators and the public. Except for technical amendments, Form ADV Part II has been unchanged for almost 30 years. NRS urges the Commission to seize this opportunity to eliminate inconsistencies and to facilitate electronic access to firms' entire Form ADV via the IAPD.

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The proposed rules presented in IA Release IA- 2711 (the "Release") will, after many intervening years since the initial Form ADV proposal, achieve a new era in investment adviser regulation. NRS most strongly supports the use of electronic filings which have been very successfully implemented over the intervening eight years and further, most strongly supports the electronic delivery of Form ADV 2 in this paperless age as noted in our following comments.

NRS places a premium on clarity and precision in the regulatory environment to promote transparency regarding the expectations of the regulator as well as the concomitant obligations of the regulated. It is in this spirit that we are pleased to submit the following comments. Please note that the order of our comments corresponds to the Release's treatment of these issues and is not indicative of our assessment of their relative importance.

## I. PART 2A: The Firm Brochure

### 1. Proposed Format

NRS strongly supports the use of plain English as proposed for the new Form ADV Part 2 ("Brochure") for several important reasons.

First, NRS believes that the plain English format represents the current industry best practice for delivering clear and meaningful disclosures to existing and prospective advisory clients, the general public, the regulatory agencies and the financial services industry overall. As it has for the mutual fund prospectus, the plain English initiative makes the most sense for the investment adviser industry and the investing public.

Second, NRS recognizes the benefits inherent in enabling advisers to create their Brochures on a flexible and highly functional system of their choice where they can take advantage of technology and utilize a broader array of formatting options. We believe that advisory clients, regulators and the industry overall will benefit from these efforts to present information in a clearer and more concise manner through the use of tables, graphs and other illustrative presentation formats. We anticipate that advisers will embrace the opportunity to create and present a more user-friendly and visually discriminating Brochure.

These advantages come with a price, of course. While the narrative approach is viewed as most desirable, it will increase, rather than minimize, the burden on advisers for creating and maintaining their Brochures. For example, eliminating the check-the-box format will result in a longer document because fundamental information that is currently provided in response to Items 1 through 5 in Part II may require a longer narrative presentation. NRS suggests that the Commission consider this issue and provide clarification in the Final Rule as to the degree of detail that will be required (e.g., must the adviser list all the types of securities on which it offers advice thereby providing the same specificity that is currently disclosed in Item 3). NRS has noted that advisers rarely avail themselves of the option to use a narrative brochure in lieu of Form ADV Part II, due in large part we believe, to (1) the challenge of incorporating all the detailed information currently required in Part II into another format while retaining a concise, professional presentation, and (2) the duplicative efforts required to produce and maintain two documents that have materially identical content, but vastly different presentation and formatting.

Based on our experience of drafting Form ADVs for thousands of advisers over several decades, and our experience helping investment companies adopt plain English prospectus standards, NRS believes the Commission has underestimated the increased burden on advisers for this conversion. More detailed comments on the increased burden are provided below.

## 2. Brochure Items

There are several very important concepts and comment areas relating to the proposed approach and format for the Brochure.

### Disclosures of Conflicts

NRS strongly endorses the Commission's proposal mandating that advisers identify and explain conflicts of interests and how the firm addresses those conflicts rather than provide summaries of the firm's policies and procedures. Disclosures that identify a conflict, explaining what that conflict is and how the adviser addresses the conflict should be much more meaningful to the advisory client than summaries or explanations of an adviser's policies and procedures.

### Item 3. Table of Contents

NRS most strongly urges the Commission to adopt and mandate a uniform approach for the Brochure with standardized order and titles for consistency and the benefit of all, i.e., clients, prospective clients, the public, regulators and advisers. Form ADV Part II and Schedule H currently have established titles and sequential reporting standards for consistency and ease of reference. Absent a uniform standard, advisory clients may be faced with significantly diverse and inconsistent Brochures that will clearly impede reasonable comparisons. We suggest that a uniform table of contents with defined titles and order sequence, combined with text searchable technology, will present the most functional and user-friendly disclosure brochure for the reader and will eliminate any need for an index for the regulatory agencies. Consider also that any Form ADV Part 2 approach mandated by the Commission will likely be adopted by the states and another 14,000 state-registered advisers, further exacerbating the effect of an ill-defined framework .

Structural uniformity that also preserves flexibility for presentation and content is the most desirable system while allowing advisory clients to easily draw comparisons amongst multiple advisers based upon clearly written and consistently presented information.

### Item 4. Advisory Business

NRS believes it is no longer necessary to require repetitive disclosures, listing all wrap programs (identified in Part 1) and periodicals, etc. Furthermore, as will be addressed in appropriate sections of this letter, NRS recommends that certain additional reporting requirements contained in the Part 2 proposal be reconsidered with a view toward identifying the primary purpose for requiring such disclosure (i.e., if it is principally for regulatory purposes the disclosure should be made in Part 1A, otherwise, disclosures should be included in Part 2), and thereby eliminating unnecessary redundancies (e.g., Item 4, calculating and reporting assets under management ("AUM"); Item 9, disciplinary disclosures; etc.). NRS provides further comments regarding these issues below.

NRS strongly urges a single standard for calculating and reporting AUM and recommends that advisers be required to disclose this information only in Item 5.F. of Part 1A. As this information is a critical component of federally registered firms' annual updating amendment filing requirements to evidence continuing eligibility - or lack thereof - to be SEC registered, it does not appear to be practicable or beneficial to also include this disclosure to Part 2.

In assisting our clients to complete their mandatory Annual Updating Amendment ("AUA") filings, NRS consistently finds that the accurate reporting of firms' AUM is one of the most problematic items that advisory firms struggle with year after year.

Allowing advisers to create their own unique methodologies of reporting AUM will result in greater confusion by some advisers, conflicting data being reported, and advisory clients being unable to effectively evaluate and compare investment advisers since there will no longer be any uniform objective standard(s) of calculation and reporting.

However, if the Commission's decision is to permit these alternative methods, which NRS strongly discourages, advisers should be required to provide an explanation as to why they have elected to utilize a different methodology, and detail their process for calculating and reporting this alternative information, e.g., assets under advisement.

#### Item 8. Disclosures of Methods of Analysis, Investment Strategies & Risks

NRS supports, and believes advisers would welcome the opportunity, to provide meaningful disclosures about specialized services such as international investing or multiple strategies to elaborate on the firm's specialty, its expertise and to differentiate itself from other advisers.

NRS also supports requirements for additional disclosures of risks for any specialized investments and investment strategies. NRS believes this is important and meaningful disclosure for prospective and existing clients. Notwithstanding this, NRS does not support any required disclosure about the effect of frequent trading or trying to define "frequent trading" due to the very diverse levels of trading activity which can be dictated by particular investment strategies, client objectives and available investments, ranging from futures to municipal bonds.

Similarly, NRS supports only general required disclosures about cash management practices as an asset class managed by the adviser. These general disclosures can and should be tailored by an adviser based upon the firm's investment strategy or strategies. NRS suggests that advisers are most able to describe these strategies because of the many complex and market driven considerations in cash management strategies and short term instruments.

For additional potentially helpful Item 8-related disclosures, the Commission might also consider facilitating advisory clients' awareness of and access to a variety of publications developed by the Commission and others for investor education. For example, the IAPD main sitemap could highlight the availability of general investor information and resources as well as provide links to various publications including, *Get the Facts: The SEC's Roadmap to Saving and Investing* and *Invest Wisely: Advice from Your Securities Industry Regulators*, available on the SEC's web site at <http://www.sec.gov/investors/pubs.shtml>, and *Cutting Through the Confusion*, available on NASAA's website at [http://www.nasaa.org/investor\\_education/Financial\\_Education\\_Resources/](http://www.nasaa.org/investor_education/Financial_Education_Resources/).

## Item 5. Fees & Compensation

NRS strongly supports the approach that clear and meaningful disclosures about the adviser's types of fees, schedules and billing processes are most important. NRS also supports the disclosures of performance fees including the actual and potential conflicts that relate to performance fee arrangements.

Further, general disclosures about other fees that may be incurred by the adviser's clients, e.g., mutual fund fees, will adequately inform clients of these other fees. To require disclosures of specific other fees, e.g., 12b-1 fees, surrender charges, commissions, custodial fees, etc., would be overwhelming and potentially confusing rather than meaningful for clients. Finally, such fees may, and do, change frequently, leading to multiple amendments, additional disclosures and confusion for clients about fees over which an adviser has no or little control.

## Item 9. Disciplinary Information

NRS has significant concerns about the overlapping, often duplicative and occasionally inconsistent disciplinary disclosure requirements. NRS wholly concurs with regulators and much of the industry in requiring full and fair reporting of disciplinary events as well as ensuring that such information is readily available to potential and existing advisory clients, among others.

Currently, federally registered advisers are required to respond to disciplinary questions in Item 11 of Part 1A, while licensed investment adviser representatives must provide any necessary disclosures in response to Item 14 of Form U4 or Item 7 in Form U5. In addition, state registered advisers must respond to questions pertaining to financial soundness, arbitration and/or regulatory and civil judicial proceedings in Item 2 of Part 1B. Any reportable events must be disclosed on the appropriate Disciplinary Reporting Page(s) ("DRPs").

In addition to these disclosure requirements, as proposed, advisers will be required to disclose in Item 9 of Part 2 "...material facts about any legal or disciplinary events that are material to a client's evaluation of the integrity of the adviser or its management." This appears to be a standard that is impossible to meet as an adviser is unlikely to know what each prospective client believes is material to their evaluation.

The current proposal considers including the following additional disclosure requirements in Part 2: cease and desist orders and/or censure orders for the firm or its management persons; arbitration awards, settlements or claims, and damages resulting from civil proceedings. NRS supports the Commission's proposal to mandate disclosure of cease and desist orders and/or censure orders, as well as civil litigation settlements, including the amount of damages awarded (regardless of the amount) upon resolution.

NRS does not agree, however, that required disclosures should include arbitration awards, settlements or claims, believing that disclosures should be made pursuant to completed legal proceedings and final settlements.

As proposed, further disciplinary disclosures must be made as necessary for Supervised Persons in response to Item 3 of the Brochure Supplement. Once again, state registered advisers will also have to disclose any reportable events in response to Item 20 in Part 2 and Item 7 in the Brochure Supplement.

DRPs mandate reporting specific information in specific data fields, while the Brochure and Brochure Supplement disclosures as proposed will be narrative in nature. NRS is concerned that this additional editorial freedom may result in inconsistencies in the reported information. This risk may be further exacerbated by nuances in how similar questions are posed across the various forms.

NRS believes that it is essential that the SEC (and state regulators) ensure that required disclosures are made in response to specifically defined formats and/or reports (i.e., DRPs). Such reports need only be filed once as repetitive filings, particularly those that are narrative in nature may result in incomplete and/or inconsistent reporting of events.

NRS further suggests that the Commission consider having all reportable disciplinary disclosures for the firm and associated persons of the firm be centralized and reported in a single document (i.e., Part 1A or Part 2) to eliminate or at least minimize the duplication of information and potential inconsistencies in reporting.

#### Item 10. Other Financial Industry Activities and Affiliations

NRS strongly urges the Commission to not include any required definition of “material relationship/affiliation” because of the many actual and potential conflicts and relations and difficulty of crafting a meaningful, comprehensive and appropriate definition. Rather than a definition, NRS suggests that the Commission set forth a guideline for advisers to determine materiality. Such a guideline could be a relationship/affiliation that a client or investor should be aware of in order to make an informed decision about whether or not to engage the adviser or to continue the relationship, similar to the materiality test for material nonpublic information. NRS submits that the burden of evaluating, identifying and disclosing such relationships is best placed on the advisers who are most knowledgeable and capable of doing so and have the fiduciary obligation to do so.

#### Item 12. Brokerage Practices

Recognizing the importance of very clear and meaningful disclosures for brokerage practices, NRS supports additional disclosures in certain areas and suggests fewer disclosures in others.

(a) Negotiating commissions. NRS supports the concept that advisers should disclose their practices of negotiating commissions. Our experience is that most advisers do, to some extent, negotiate commissions whether on a firm wide basis for brokerage platforms, by client to a varying degree, or by brokerage firm based on services, country, volume or type of securities, among other reasons. Further, the practice of negotiating commissions should be disclosed because advisers are acting on a client's behalf under the advisers' best execution and other fiduciary duties.

(b) Commission recapture programs. NRS believes no disclosures about such programs are necessary or meaningful because it has been our experience that such programs are not typical in the industry and are generally driven by sophisticated, large institutional clients.

(c) Soft dollar disclosures. NRS believes the Commission's latest release on soft dollar practices and guidelines for disclosures is generally sufficient except that NRS

suggests that the Commission consider additional guidelines and disclosures for products and services obtained outside the Section 28(e) safe harbor. Additional actual and potential conflicts are raised by such arrangements.

(d) Aggregation of trades. NRS supports disclosures about an adviser's aggregation practices because our experience reflects that most advisers do not currently include any such disclosures. We believe disclosures regarding these trading practices are helpful and meaningful for clients. For example, an adviser's practices and the benefits received if trades are aggregated should be disclosed. Likewise, if trades are not aggregated, or if aggregation is done only by portfolio manager(s) and not on a firm-wide basis, such disclosures including any advantages or disadvantages should be provided, e.g., order rotation process.

#### Item 15. Custody

Currently, the only custody disclosure in all of Form ADV are several check boxes at Item 9 of Form ADV Part 1, which is not required to be delivered to clients and, as such, is read by few clients or prospective clients. While the amended custody rule has been helpful, custody is still a confusing area for advisers based on our experience. NRS supports a brief summary of an adviser's custody practices including whether or not the adviser has custody and the basis for that determination, e.g., acting as a general partner of an affiliated investment fund.

#### Item 16. Investment discretion

NRS believes current disclosures are relevant and appropriate for advisers with investment discretion. Eliminating the check-the-box format, however, leaves a gap for any disclosure regarding an adviser's practices when the adviser has no discretionary authority. To fill this absence, NRS suggests that this item be expanded to disclose an adviser's practices when no investment discretion exists, i.e., client approval of investment decisions, order rotation, etc. Such disclosures should also recognize the disadvantageous consequences to those clients.

#### Item 17. Voting Client Securities

NRS supports additional disclosures regarding the retention of third party proxy voting services so that clients may be informed as to who may actually be voting proxies for clients' portfolio securities. This is consistent with the current SEC Proxy Rule 206(4)-6 requirements and with the practice of only requiring disclosures that are generally meaningful and appropriate for clients. NRS does not support additional disclosures about how any proxy service provider is selected, the cost of such services or whether any soft dollar arrangement covers the proxy services as such disclosures would not be meaningful for advisory clients.

#### Item 19. Index

NRS submits that if a standardized format, order and table of contents are adopted in a word searchable format, it is inconsistent and unnecessary to propose an index for any purpose.

## II. DELIVERY & UPDATING OF BROCHURES

NRS endorses the mandate that advisers initially deliver their firm's Brochure to each new advisory client. We share the concerns of many commenters, however, about ongoing Form ADV delivery obligations. NRS respectfully suggests that the Commission consider the economic, operational and environmental impact of any ongoing Form ADV Part 2 delivery requirements to many millions of clients. Please consider that the delivery requirement will apply to some 11,000 SEC advisers providing services to 20 million clients as noted on page 4 of the Release. Further, please consider the additional 14,000 state-registered advisers delivering Form ADV Part 2 to many more millions of their clients. NRS urges the Commission to recognize the concept of "access equals delivery" for certain clients as noted in prior releases and by other commenters.

Procedurally, whenever a Part 2 filing is submitted on the IARD system, that filing includes Form ADV Part 1. Consequently, the firm's entire 'current' Form ADV is accessible for public viewing when that filing is posted on the IAPD. To view an adviser's Brochure online, individuals may elect to access it as part of the firm's complete Form ADV, or view only the Brochure by selecting Part 2 Brochures directly from the Navigation Bar.

Accessing an adviser's Form ADV via the IAPD is a relatively simple and efficient process (although load times can vary significantly). Given modern technology most individuals with basic computer skills should have no difficulty viewing a firm's Form ADV online.

Appreciating that (1) most advisers would prefer not to have to deliver their firm's Brochure each time an amendment is filed, (2) most clients never respond to advisers' annual offer of Form ADV Part II, and (3) most clients may, in fact, prefer not to receive paper updates, NRS urges the Commission to consider and mandate that ongoing delivery requirement(s) be achieved through utilization of the IAPD.

Broadly speaking, current Commission guidelines<sup>1</sup> permit investment advisers (among others) to satisfy their delivery obligations using electronic means provided they implement certain procedures. Those procedures (which perhaps should be updated) include obtaining informed consent from the client, establishing safeguards to ensure that electronic communications are delivered (e.g., monitoring for any notification of delivery failure(s) with appropriate follow-up), and providing hardcopy documents upon client request.

Recognizing that Form ADV Part 1 contains significant disclosures, particularly pertaining to disciplinary events, NRS believes that many of the objectives of the re-proposal of Part 2 may be more easily achieved by requiring delivery (see comments below regarding electronic delivery) of a firm's full Form ADV to advisory clients. This approach should effectively eliminate the need for duplication of disciplinary disclosures as well as other repetitive information (e.g., reporting of assets under management).

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<sup>1</sup> See Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release Nos. 33-7288; 34-37182; IC-21945; IA-1562; File No. S7-13-96 (May 9, 1996)



We further suggest that the Commission consider allowing advisers to fulfill their ongoing delivery obligations to clients by allowing the adviser to send notification to clients each time an amendment is filed. Such notification should include a summary of changes made, and provide detailed instructions (and/or a link) for accessing the firm's Form ADV filing on the IAPD system. Advisers would still be obligated to deliver hardcopy documents to clients that do not provide informed consent for electronic delivery or who otherwise request a hardcopy.

Mandating Part 1 amendments corresponding to Part 2 amendments, as appropriate, should not add a significant operational burden to advisers because amendments to Form ADV Part 1 are relatively easy to complete due to the 'check-the-box' format of much of the form. In fact, the combination of time, effort and resources that would be saved through the elimination of repetitive disclosures and more burdensome delivery requirements would more than substantially offset any additional time spent updating Part 1. Ultimately, we believe that advisory clients will benefit from having ready access to more current, consistent (and therefore more accurate) information concerning investment advisers.

### III. APPENDIX A

#### A. General Instructions

Consistent with our comments pertaining to delivery and updating of Form ADV, NRS recommends that the SEC reconsider the existing updating requirements as certain changes in many sections of Form ADV (e.g., Items 6, 7 and 8 in Part 1A, and Items 4, 5, 8, 10, 12, 15, 16, in Part 2) can have significant implications that would be deemed to be material. Often we see that advisers will simply rely on the listed Item numbers currently provided in the General Instructions rather than conduct a more in-depth evaluation of the changes to determine whether or not such changes would be deemed to be material and therefore warrant prompt amendments. Consequently, we recommend that the Commission consider eliminating the specific listing of item numbers and instead provide a succinct summary of updating requirements (e.g., promptly if there is any material change in the adviser's responses). The General Instructions should also plainly state that all items must be updated at least annually.

NRS also urges the Commission to include guidance on the appropriate application of the term 'material' as part of such a summary.

#### B. Form ADV: Instructions for Part 1A

In the examples provided for Item 5, Item 5.b.(3)(c)(d) states, "you are a broker-dealer and treat the account as a brokerage account, but only if you have discretionary authority over the account." NRS believes this item should be deleted pursuant to the reversal of Rule 202(a)(11)-1, commonly referred to as the "Merrill Lynch Rule."

### IV. APPENDIX B

NRS recommends that the Glossary be expanded to include the following:

1. **IARD**: the current glossary includes the acronym for FINRA CRD or CRD; however, the IARD is far more pertinent to investment advisers.

2. **You:** As this term is frequently misinterpreted, including a definition in the glossary may reduce some confusion. In addition, we recommend that there be greater focus brought to the appropriate application of this term within Form ADV Part 1. For example, as a defined term "you" could then be italicized within the body of the Form ADV in the same manner that other defined terms (e.g., Principal Office and Place of Business, clients, etc.) are to enable users to quickly see and therefore reference the definition. Since responses to Items 6 and 7 in Part 1A are frequently incorrect as a result of the improper application of the term 'you' (i.e., applied to the firm rather than individuals associated with the adviser), providing some guidance in these specific items may reduce the number of erroneous responses in these sections.

## V. PART 2B BROCHURE SUPPLEMENT & BROCHURE SUPPLEMENT FILING REQUIREMENTS

While NRS supports the Commission's objectives to provide advisory clients with meaningful information about the professionals managing their assets, we recognize the potential challenges that advisers will face in meeting this compliance obligation, particularly in conjunction with the burden of fulfilling all of the other requirements contained within this proposal.

Not surprisingly, a wide range of advisory firms are extremely concerned about the resources required, and their ability to meet the compliance obligations under the proposal. As noted by many previous commenters, the mechanics of creating, delivering, and maintaining Brochure Supplements for every individual who meets the reporting requirements are formidable. This challenge is further exacerbated by the firm's need to track each client relationship on an individual basis to ensure that any required amendments to an individual's brochure supplement is appropriately delivered to everyone of his/her advisory clients.

In 2000, the initial proposal to amend Form ADV imposed a similar array of significant compliance obligations. At that time the Commission recognized the benefits of establishing multiple stages of implementation and compliance deadlines. We suggest that the Commission consider utilizing that same methodology in establishing compliance deadlines for this component of the proposal.

For a number of years brokerage clients have been able to obtain online (via a web site established and maintained by FINRA) a limited amount of background information about the registered representative(s) responsible for their brokerage accounts. Recently that site, now "BrokerCheck," was revamped and the amount of available information significantly increased. It is worth noting that the IAPD already includes a link to BrokerCheck.

NRS suggests the Commission postpone implementation of the Brochure Supplement until such time as a parallel electronic filing/reporting system is established for investment adviser representatives. Assuming that the SEC adopts this approach to fulfill the Brochure Supplement requirements thus enabling advisers to fulfill their compliance obligations electronically, such a portal can substantially alleviate much of the operational burden that advisers will face under the current proposal. We believe that this proposed concept is consistent with our earlier recommendations regarding the filing, updating and delivery of Form ADV.

If the Commission decides to initially postpone the implementation of the Brochure Supplement, it may wish to consider whether to require advisers, in the interim, to disclose in Part 2 the information currently required in Item 6 of Part II.

We appreciate the opportunity to comment on the Release and this industry shaping restructuring of Form ADV for the benefit of so many. If any further information may be of assistance, or if the Commission has any questions regarding this comment letter, we would be pleased to assist further.

Respectfully submitted,

William Cavell  
Vice President  
NRS Compliance Institute