NSCP
NATIONAL SOCIETY OF
COMPLIANCE PROFESSIONALS

February 7, 2020

VIA CERTIFIED MAIL AND EMAIL

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Investment Adviser Advertisements; Compensation for Solicitations (File No. S7-21-19)

Dear Ms. Countryman:

The National Society of Compliance Professionals ("NSCP")[1] appreciates the opportunity to provide comments to the United States Securities and Exchange Commission (the "Commission") on proposed amendments to Rule 206(4)-1 (the "Advertising Rule") and Rule 206(4)-3 (the "Solicitation Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), which would amend rules governing investment adviser advertisements and payments to solicitors (the "Proposed Amendments").[2] These comments relate, in particular, to the obligations of Chief Compliance Officers ("CCOs") under the proposed amendments to the Advertising and Solicitation Rules.

The NSCP strongly supports the Commission's efforts to modernize the Advertising Rule and its move to a principles-based regulatory framework, but NSCP nevertheless has certain concerns about the scope and lack of specific guidance in the Proposed Amendments. From a CCO's perspective, we believe the proposed changes to the Solicitation Rule are welcome and we applaud the Commission's efforts. Our views, as well as our concerns

[1] The Proposed Amendments are of considerable interest to NSCP and its members. NSCP is a nonprofit, membership organization with approximately 2,000 financial services compliance professionals dedicated to advancing the expertise of financial services compliance professionals and the long-term success of the compliance profession. The principal purpose of NSCP is to provide its membership best in class resources, provide opportunities for professional development, promote the exchange of knowledge and advocate for the compliance profession.

NSCP's membership is drawn principally from traditional broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the law firms, accounting firms, and consultants that serve them. The asset management members of NSCP span a wide spectrum of firms, including employees from the largest brokerage and investment management firms to those operations with only a handful of employees. The diversity of our membership allows NSCP to represent a large variety of perspectives in the asset management industry.

[2] See Proposed Amendments to Rules 206(4)-1 and 206(4)-3 of the Advisers Act contained in the "Proposed Rule: Investment Adviser Advertisements; Compensation for Solicitations;" Release No. IA-5407, File No. S7-21-19, November 4, 2019.

over the Advertising Rule are discussed below.

A. Advertising Rule Proposal

Amendments to the Advertising Rule provide welcome relief, and NSCP is grateful that the Commission has, after decades without amendment, proposed to modernize the rule. The Proposed Amendments, however, would create a final rule that is overly broad, lacks clear guidance in certain key areas, and has the potential to place a heavy burden on CCOs and other compliance professionals. Therefore, NSCP respectfully requests the Commission address the concerns discussed below in the final adopting release and/or the final rule.

1. Definition of "Advertisement"

We generally applaud the Commission's proposed amendments to the definition of "advertising," which are designed to provide flexibility such that the rule may later be applied to new media without further amendments. However, the proposed definition is so broad that it would require prior review of nearly every written communication to determine whether or not such communication is an advertisement subject to the rule's requirements. While we appreciate the Proposed Rule would exclude one-on-one communications from the required employee review requirement of proposed Section 206(4)-1(d), such communications would nonetheless require prior review to determine whether or not the rule's other requirements apply. Given the breadth of the definition, registrants would have little choice as a matter of policy but to either assume all communications are advertisements or to review all communications prior to dissemination, effectively negating the exclusion of one-on-one communications from the employee review requirement. Accordingly, adopting the rule as proposed would place an undue burden on compliance professionals.

Furthermore, while one-on-one communications would be excluded from the employee review requirement, compliance professionals would still be required to adopt reasonable policies and procedures to prevent and detect violations of the rule in these communications, which would require post-dissemination testing. Accordingly, given the significant increase in the number of communications requiring both prior review to determine whether they are advertisements and post-dissemination review to detect violations, adopting the rule as proposed would place an undue burden on compliance professionals. The Proposed Amendments state that the Commission decided to include one-on-one communications in the definition of *advertisement* because of their concern that changes in technology now permit advisers to create communications that appear to be personalized to single clients and are "addressed to" only one person, but are actually widely disseminated to multiple persons. However, this concern can simply be addressed through policies preventing the use of technology to circumvent the rule along with appropriate training regarding the same.

We believe the industry has been moving towards greater transparency to better serve the interest of investors, but the strain on resources likely to be caused by such a broad definition of "advertisement" would have a chilling effect on communications with existing investors. Accordingly, we request the definition of advertisement include an exception for one-on-one communications prepared for the specific recipient rather than through software for "personalizing" bulk communications. Alternatively, we request the definition of advertisement include an exception for one-on-one communications with existing clients.

2. *Guidance on Developing Policies and Procedures*

We also applaud the Commission's expansion of permissible advertisements, including the use of testimonials, endorsements and performance information. The expansion of permissible advertisements in the Proposed Amendments is largely a result of the Commission's move to a principles-based approach. In light of the proposed shift to a principles-based approach, compliance professionals need more guidance on developing policies and procedures that are reasonably designed to comply with the Advertising Rule.

We welcome the flexibility that comes with a principles-based approach, but absent clear guidance on the types of policies and procedures the Commission would consider to be "reasonably designed" for purposes of the amended Advertising Rule, compliance professionals would not be able to adequately train employees, establish enforceable compliance policies or determinations,[3] or avoid unintended violations of the rule. Indeed, whether an advertisement is "misleading" depends on the particular facts and circumstances and can, therefore, be a subjective determination under a principles-based approach and is susceptible to an "after the fact" assessment. More guidance is necessary to help firms develop a reasonable compliance framework.

In addition to new policies and procedures around a broader universe of permissible advertisement, the proposed rule also requires compliance professionals to develop and implement other new policies and procedures. As detailed below, additional guidance would be helpful with respect to the policies and procedures firms must develop, in particular, around the use of hypothetical performance and the mandatory employee review process.

The need for guidance is particularly important because many current adviser advertising practices are built around standards or expectations enunciated over time in SEC "no-action" letters. In the Proposed Amendments, the Commission explained that it is considering whether to withdraw certain no-action letters, including several foundational no-action letters, like *Clover Capital Mgmt., Inc.,* SEC Staff No-Action Letter (pub. avail. Oct. 28, 1986), on which compliance professionals often rely in designing and implementing compliance policies and procedures. Complying with the bright line terms and conditions of the no-action letters gives compliance professionals confidence that they are doing enough to prevent unintended violations. To the extent letters are, in fact, withdrawn, they should be replaced with guidance from the Commission either in the final rule adopting release and/or codified in the final rule.

To the extent the Commission decides to withdraw no-action letters because the new rule is more expansive, we would ask the Commission to consider establishing safe harbors for firms that continue to comply with the terms and conditions of the withdrawn letters. We believe this approach would be consistent with the Commission's statements in the proposing release. For example, the Commission is proposing to withdraw The TCW Group, SEC Staff No-Action Letter (Nov. 7, 2008) (the "TCW Letter"). However, in the proposing release the Commission states it believes an advertisement that includes the information required under the TCW Letter would likely meet the new "fair and balanced" standard for presenting specific investment advice.[4] While we

[3] Our members are particularly concerned about enforcing compliance revisions to advertisements without clear support for the same in Commission guidance.

[4] *See,* The TCW Letter (not recommending enforcement action provided that the adviser met certain other conditions such as presenting best and worst-performing holdings on the same page with equal prominence; disclosing that the holdings identified do not represent all of the securities purchased, sold or recommended for the adviser's clients and that past performance does not guarantee future results; and maintaining certain records, including, for example, evidence

appreciate the flexibility afforded by the Commission in permitting advisers to use alternative ways to present specific investment advice outside of the TCW Letter, we ask for safe harbor for those advisers who do continue to comply with the TCW Letter and any other no-action letter the Commission withdraws.

If the Commission withdraws no-action letters without promulgating new guidance, it will create the potential for unintended consequences, including the risk of regulation by enforcement or a new wave of requests for no-action relief. We agree with Chairman Clayton that "*[i]t is incumbent on the Commission to write rules so that those subject to them can ascertain how to comply and — now more than ever — how to demonstrate that compliance.... However, the Commission needs to make sure at the time of adoption that we have a realistic vision for how rules will be implemented as well as how we and others intend to examine for compliance.*"[5] We would suggest that the Commission's interpretive release relating to the standard of conduct for investment advisers—another area where the Commission has adopted a principles-based approach—provides a helpful example of the guidance needed with respect to the Advertising Rule.[6]Accordingly, we request guidance on developing policies and procedures from the Commission either in the final rule adopting release and/or codified in the final rule.

3. Required Employee Review of Advertisements

The Proposed Amendments would require a designated employee to review and approve every advertisement for consistency with the Advertising Rule before disseminating the advertisement, except for advertisements that are: (i) communications that are disseminated only to a single person or household or to a single investor in a pooled investment vehicle; or (ii) live oral communications that are broadcast on radio, television, the internet, or any other similar medium. Without modification, requiring employee reviews of nearly all advertisements would create significant impediments to an adviser's ability to communicate with current or potential investors. We applaud the Commission for excluding one-on-one advertisements, but we believe the final rule should also include exceptions for certain advertisements to more than one person. In particular, we believe the Commission should provide an exception to the employee review requirement for advertisements that include only pre-approved content from an internal library cataloging material by appropriate use and intended recipient. We believe this methodology is well-used in the industry and embraces technology to automate compliance functions by ensuring business teams are accessing and using only pre-approved, up-to-date advertising materials. Using technology solutions also creates an audit trail making compliance oversight and testing more effective and efficient.

We also ask for clarification on, or an expansion of, the permitted persons who may conduct the required employee review. Many members use third parties, such as attorneys and compliance consultants, to conduct reviews of advertisements because of their significant knowledge and experience. While the Proposed Amendments indicate that designated employees generally should include legal or compliance personnel of the adviser, it does not clarify whether the legal or compliance personnel must be actual employees of—rather than consultants to—the adviser. We note that in other contexts, such as on Form ADV, the Commission has taken a broader view of the term "employee" to include independent contractors.

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supporting the selection criteria used and supporting data necessary to demonstrate the calculation of the chart or list's contribution analysis).

[5] *See* Jay Clayton, SEC Chairman, Remarks at the Economic Club of New York (July 12, 2017), available at https://www.sec.gov/news/speech/remarks-economic-club-new-york.

[6] See SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals, SEC Press Release No. 2019-89 (June 5, 2019), available at https://www.sec.gov/news/press-release/2019-89.

For these reasons, we would ask for clarification as to when it would be appropriate or permissible for an employee who is neither in legal or compliance to conduct reviews. For example, would it be sufficient for compliance professionals to train non-legal or compliance employee reviewers? Would compliance professionals need to review their work prior to dissemination of reviewed communications? Would CCOs be subject to supervisory liability with respect to non-legal or compliance employee reviewers?

4. Retail and Non-Retail

We support the Commission's recognition that certain advertisements carry greater risks than others, depending on the intended audience. We are, however, concerned with the lack of guidance as to the types of policies and procedures compliance professionals should design and implement to ensure that *non-retail advertisements* are disseminated only to *non-retail persons*. We are also concerned with the practical implications of using the proposed "*retail person*" and "*non-retail person*" definitions to classify intended audiences.

The Proposed Rule would adopt the "reasonable belief" approach in Rule 2a51-1(h) under Investment Company Act of 1940 (the "Investment Company Act") to allow an investment adviser to provide a *non-retail advertisement* to an investor that the investment adviser reasonably believes is a qualified purchaser. While Rule 2a51-1 has existed for twenty years, and many investment advisers have developed policies and procedures to implement this "reasonable belief" provision under the Investment Company Act, there is no SEC guidance as to what would be reasonable in the context of disseminating advertisements. As explained in the Proposed Amendments, the "reasonable belief" standard might apply differently to an adviser's evaluation of advertisements directed at potential customers or investors for which the adviser has not yet had an opportunity to perform the due diligence that might be common for evaluating whether an investor is qualified to invest. Since the "qualified purchaser" test is conducted at the time of purchase, typically, compliance policies and procedures rely on self-certifications in private fund subscription agreements or on the sufficiency of the subscription amount. Applying these "qualified purchaser" policies and procedures in the context of advertisements would require investment advisers to qualify every recipient as a *non-retail person* prior to disseminating advertisements or otherwise designing a dissemination process that prevents access by *retail persons*.

For example, would the Commission permit an adviser to rely on a "clickwrap" or "splash screen" feature to obtain self-certification from prospective clients in order to satisfy "reasonable belief" standard (absent the adviser's actual knowledge of facts contrary to the certification)? Such features are used by certain advisers to ensure websites are accessed only by residents of permitted jurisdictions or certain qualified investors. What, if any, additional minimum safeguards would be required to ensure *retail persons* do not simply click through to obtain *non-retail advertisements*? Accordingly, we ask the Commission to provide examples of acceptable procedures for evaluating whether advertisements are directed only to *non-retail persons*.

5. Negligence Standard

Our membership is concerned about compliance professionals' increased exposure to disciplinary liability if the Proposed Amendment are adopted as written. Advisers Act Rule 206(4)-7 requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules and must designate a CCO to administer the same, but the Advisers Act offers no distinction between the role of the CCOs and management in carrying out the compliance function. Although traditionally, the role of a CCO does not assume responsibility for their firm's overall supervisory and compliance obligations,

the subjective nature of the principles-based approach to the proposed rule is cause for concern—in particular, if the Commission finds CCOs fail to act reasonably in adopting new policies or procedures or fail to supervise employees conducting reviews or fail to properly confirm and categorize relevant fees and expenses in performance advertisements.

The proposing release reminds us that to establish a violation of the proposed rule, the Commission would not need to demonstrate that an investment adviser acted with scienter; negligence is sufficient. While negligence standard is not new to 206(2), the Commission has historically taken the position that simple negligence is not enough and has expressed unwillingness to pursue enforcement against CCOs individually except in the extreme circumstances of participating in a firm's wrongdoing; hindering the SEC examination or investigation; and wholesale compliance failures. We request clarification that the Commission's position remains that the ultimate responsibility for implementation of policies and procedures rests with the adviser itself and that absent extreme circumstances, CCOs will not be second-guessed or held accountable.

Conclusion

We appreciate your consideration of our comments and recommendations. While we strongly support the Commission's efforts to modernize the Advertising Rule and its move to a more principles-based approach, without further guidance and modification we believe that much of what the rules contemplate would place an undue burden on compliance professionals.

Sincerely,

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