February 10, 2020

Via Electronic Submission

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Proposed Rule on Investment Adviser Advertisements; Compensation for Solicitations (RIN: 3235-AM08; Release No. IA-5407; File No. S7-21-19)

Dear Ms. Countryman:

Managed Funds Association[1] ("**MFA**") and the Alternative Investment Management Association[2] ("**AIMA**", and together with MFA, the "**Associations**") welcome the opportunity to comment on the Securities and Exchange Commission (the "**Commission**") proposed rule release on "Investment Adviser Advertisements; Compensation for Solicitations" (the "**Proposed Rule Release**")[3] regarding the proposed amendments to Rule 206(4)-1 (the "**Proposed Advertising Rule**") and the proposed amendments to Rule 206(4)-3 (the "**Proposed**

[1] Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] The Alternative Investment Management Association is the global representative of the alternative investment industry, with around 2,000 corporate members in over 60 countries. AIMA's fund manager members collectively manage more than $2 trillion in hedge fund and private credit assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programs and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA set up the Alternative Credit Council ("**ACC**") to help firms focused in the private credit and direct lending space. The ACC currently represents over 170 members that manage $400 billion of private credit assets globally. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation ("**CAIA**"), the first and only specialized educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors).

[3] Investment Adviser Advertisements; Compensation for Solicitations, 84 Fed. Reg. 67518 (Dec. 10, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-12-10/pdf/2019-24651.pdf.

Solicitation Rule"), both under Section 206 ("**Section 206**") of the Investment Advisers Act of 1940, as amended (the "**Advisers Act**").

The Associations broadly support the Commission's efforts to update and modernize current Rule 206(4)-1 (the "**Current Advertising Rule**") and current Rule 206(4)-3 (the "**Current Solicitation Rule**"). In particular, we appreciate the Commission's recognition that a number of prohibitions in the Current Advertising Rule are dated and warrant revisiting. As the Commission knows, the Current Advertising Rule and related staff guidance create a number of practical difficulties for private fund investment advisers as well as for sophisticated investors who "often want and have the resources to evaluate information that the current rule may restrict".[4] Therefore, the Associations applaud the Commission's desire to reconsider the current regulatory framework that applies to investment adviser advertisements and to consolidate and codify existing staff relief and guidance that remains relevant.

However, the Associations also have significant concerns with the Proposed Rule Release. Above all, we are very concerned that the Proposed Advertising Rule would impair the ability of investment advisers to communicate with clients and investors. As a result, the Proposed Advertising Rule would reduce transparency, which is essential to sophisticated investors in evaluating and monitoring both their prospective and existing investments and their relationships with the investment advisers that manage such investments. Specifically, the overly broad definition of "advertisement" along with other aspects of the Proposed Rule Release may lead to unworkable, confusing, and/or costly real-world outcomes to the detriment of investment advisers, their clients, and investors. We believe that, if adopted as proposed, the Proposed Advertising Rule would dramatically increase the scope of material subject to internal review by investment advisers. Thus, the Proposed Advertising Rule would result in increased operational burdens and costs, diminish the content and speed of communications with clients and investors, and ultimately, reduce the ability of clients and investors to appraise and monitor current and potential investments. Relatedly, we believe the economic analysis presented in the Proposed Rule Release materially underestimates the costs of the Proposed Advertising Rule and Proposed Solicitation Rule to investment advisers, their clients, and their investors.

The Associations emphasize that we strongly desire to be a constructive resource to the Commission as it refines the Proposed Advertising Rule and Proposed Solicitation Rule. MFA has advocated for modernization of the Current Advertising Rule for years, and the Associations believe there is a path forward that is consistent with the Commission's goal of adopting a principles-based approach that both adequately protects clients and investors and provides them with access to the information that they want and need. To that end, we provide comments and recommendations in this letter that we believe would strike this balance if implemented.

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[4] *Id.* at 67521.

I. EXECUTIVE SUMMARY

1.1 Proposed Advertising Rule

The Associations agree with the Commission that "advertisements are a useful tool"[5] for clients, investors, and investment advisers alike. Advertisements allow investment advisers to attract new clients and investors by explaining and illustrating their services, investment approaches, and products. Clients and investors benefit from this flow of information because it results in a dialogue between them and investment advisers wherein they ask questions that enable them to gain understanding and make more informed investment decisions. Advertisements also promote a competitive and innovative marketplace by creating a path to entry for new industry players and products.

Notwithstanding the clear benefit of advertisements, the Associations recognize the need to have a regulatory framework that prevents the dissemination of misleading or untrue advertisements. When clients and investors trust the reliability of the advertisements that they receive, their confidence in selecting investment advisers and making investment choices increases, which is to the benefit of all.

We are concerned, however, that the framework contemplated by the Proposed Advertising Rule goes too far, is overly prescriptive in places, and would ultimately frustrate these goals. The Proposed Advertising Rule helpfully would withdraw some of the most outdated elements of the Current Advertising Rule, and thus, would have the potential to further modern means of communication between investment advisers and their existing and potential clients and investors. Unfortunately, the totality of the Proposed Advertising Rule would drastically impair the useful flow of information to clients and investors, and thus, directly harm them as a result.

Among the Associations' significant suggested modifications to the Proposed Advertising Rule are the following:

1.1.1 <u>Limit the definition of "advertisement" and eliminate the pre-use review and approval mandate.</u>

The Associations strongly believe that the aspect of the Proposed Advertising Rule that has the greatest potential to chill the flow of information to clients and investors is the breadth of the proposed definition of "advertisement".[6] This expansive definition would: (i) significantly reduce the flow of information from investment advisers to clients and investors, including communications limited to existing investments and general market commentary; (ii) unduly complicate ordinary-course interactions with third parties, including investment consultants and the press; and (iii) substantially and unnecessarily complicate investment advisers' compliance obligations. Moreover, the combination of the expansive definition and the proposed pre-use review and approval mandate[7] would increase exponentially the costs and the operational and

[5] *Id*. at 67519.

[6] *See* Proposed § 275.206(4)-1(e)(1).

[7] *See* Proposed § 275.206(4)-1(d).

compliance burdens for investment advisers. To avoid unduly stifling positive and responsible communications, the Associations urge the Commission to:

(1) Exclude communications addressed to a single person (*i.e.*, a natural person or entity) from the definition of "advertisement" (as under the Current Advertising Rule and many other analogous regulatory schema that govern similar activity);

(2) Eliminate the proposed "by or on behalf of" language, or in the alternative, provide adequate safe harbors in the rule for ordinary course activities that investment advisers engage in with third parties, such as interactions with the press and investment consultants, and the provision of awards submissions to industry publications;

(3) Eliminate the term "promote", or in the alternative, clarify that the term "promote" does not expand the definition of "advertisement" beyond its meaning under the Current Advertising Rule;

(4) Carve out certain important investment adviser communications from the definition of an "advertisement", including the following: (i) market commentary that does not reference the investment adviser's investment products; (ii) communications sent solely to an investment adviser's existing clients or investors or to prospective clients and investors upon their specific request (*e.g.*, risk reports, portfolio updates, and client or investor newsletters); (iii) general announcements relating to an investment adviser's personnel, philanthropic activities, firm awards, or general business developments; (iv) prospectuses, private placement memoranda, and similar offering documents; and (v) interviews or firm profiles conducted by a third-party media publication that are not focused on offering an investment adviser's products or services; and

(5) Eliminate the proposed pre-use review and approval mandate in favor of continuing the current requirement that an investment adviser reasonably design its policies and procedures to maintain compliance with applicable rules.

1.1.2 Eliminate prescriptive requirements.

The Associations have significant concerns with the many prescriptive requirements contained in the Proposed Advertising Rule. The Commission proposes to withdraw a number of requirements in the Current Advertising Rule because each is a detailed and outdated proscription, rather than a durable principle. Unfortunately, we see numerous parallels in the Proposed Rule Release.

For example, the Commission's proposed "general prohibitions" contain seven variations on the otherwise straightforward concept that an "advertisement" should not be misleading.[8] This prescriptive approach risks confusion in application and unintended consequences. Therefore, the Associations urge the Commission to reconsider the proposed prescriptive requirements in

[8] *See* Proposed § 275.206(4)-1(a).

favor of continued reliance on the simpler and clearer anti-fraud standard from the Current Advertising Rule, which would create a true principles-based approach.[9]

1.1.3 Include qualified clients and accredited investors in the "Non-Retail Person" definition.

While the Associations appreciate the Commission's proposed distinction between advertisement requirements for a "Retail Person" and a "Non-Retail Person", we object to the Commission's proposed categorization of an "accredited investor" or a "qualified client" as an unsophisticated "Retail Person". We disagree with the Commission's assertions that these clients and investors need special protection with respect to their communications with investment advisers,[10] especially because such protection comes at a significant cost, including limits on the access clients and investors would have to important market information. In fact, these categories of clients and investors often have the resources, financial sophistication, and experience required to evaluate and pursue complex investment opportunities.

We further view the Commission's approach as inconsistent with the recent private offering concept release[11] and the proposed updates to the "accredited investor" definition[12] as both proposals support a responsible expansion of access to private investments. We believe that in the Proposed Advertising Rule the Commission similarly should empower accredited investors and qualified clients, and not limit their access to important informational sources. Therefore, we respectfully encourage the Commission to reconsider its proposed approach, and instead include accredited investors and qualified clients in the definition of "Non-Retail Person".

The Associations emphasize that this issue is a fundamental concern with the Proposed Advertising Rule. The improper classification of sophisticated investors and clients within the "Retail person" definition would have negative impacts for investors, clients, and investment advisers, and is one source of our concerns with many other requirements contained in the Proposed Advertising Rule as detailed herein.

1.1.4 Provide a more flexible approach to the disclosure requirements accompanying "hypothetical performance".

The Associations believe that the Proposed Advertising Rule's treatment of "hypothetical performance" is overbroad, unworkable, and if read literally, threatens to require disclosure of

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[9] Paragraph 5 of the Current Advertising Rule (prohibiting an "advertisement" "which contains any untrue statement of a material fact, or which is otherwise false or misleading" (Commission Rule § 275.206(4)-1(a)(5))) already does what we suggest here, as does Commission Rule § 275.206(4)-8 relating to pooled investment vehicles (prohibiting "any untrue statement of a material fact or … omit[ting] to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading . . .").

[10] *See e.g.*, Proposed Rule Release, *supra* note 3, at 67548–49, 67620.

[11] Concept Release on Harmonization of Securities Offering Exemptions, 84 Fed. Reg. 30460 (June 26, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf (the "**Private Offering Concept Release**").

[12] Amending the "Accredited Investor" Definition, 85 Fed. Reg. 2574 (Jan. 15, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-01-15/pdf/2019-28304.pdf (the "**Accredited Investor Release**").

valuable and proprietary intellectual property.[13] In particular, the Associations see two primary issues.

First is that, as a definitional matter, the Proposed Advertising Rule defines "hypothetical performance" broadly to include various different types of performance information that have disparate uses, risk profiles, and complexities, and then imposes the same regulatory requirements on these varied types of information. We believe that such an overbroad definition, together with the substantive requirements associated with the use of any type of hypothetical performance, is unworkable and contrary to the Commission's goals of a principles-based regulatory structure.

Second, the Associations are concerned with the substance and detail of the proposed disclosure requirements for "hypothetical performance" information. To comply with these disclosure requirements, investment advisers seemingly would have to disclose highly confidential and proprietary information about their investment processes. Such information may relate directly to an investment adviser's investment insights and competitive advantage in trading markets for the benefit of the investment adviser's clients and investors. Therefore, in practice, we believe requiring these disclosures would prevent investment advisers from making useful performance presentations (which sophisticated clients and investors demand in many cases) because of the risk of revealing the valuable intellectual property that underlies their investment processes. Thus, this approach would harm clients and investors, who would receive less information with which to assess important investment decisions. Therefore, the Associations submit that the Commission should revisit its proposed treatment of these different categories of performance in favor of a more flexible approach that would allow investment advisers to scale the scope of disclosures to the risk profile of the type of "hypothetical performance" information used.

1.2 Proposed Solicitation Rule

The Associations appreciate that the Commission thoughtfully reconsidered some of the more cumbersome operational elements of the Current Solicitation Rule. Elimination of redundancies and generally increased operational flexibility would indeed represent a modernization of the Current Solicitation Rule. Nevertheless, certain elements of the Proposed Solicitation Rule introduce significant ambiguity regarding the contours of the rule's applicability and/or impose cumbersome operational elements that we believe are contrary to the Commission's intent. Accordingly, the following are our primary suggestions with respect to the scope of the Proposed Solicitation Rule:

1.2.1 <u>Limit the rule to cash compensation.</u>

The Associations do not view the Proposed Solicitation Rule's extension to cover non-cash compensation as workable in practice. In lieu of the reasonably clear line drawn under the Current Solicitation Rule (between cash and other forms of compensation), this expansion would give rise to ambiguity and difficult line-drawing exercises.

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[13] *See* Proposed §§ 275.206(4)-1(c)(v)(B)–(C).

We acknowledge the Commission's concern that "the provision of non-cash compensation for referrals creates the same conflicts of interest as cash compensation for referrals".[14] In the abstract, we understand that a single rule addressing all such conflicts might be desirable. Nevertheless, as currently drafted, the Proposed Solicitation Rule would not work in practice as every mutually beneficial arrangement between an investment adviser and a potential facilitator of client relationships would be subject to scrutiny for indicia of *quid pro quo* solicitation. Consider the following examples:

- A large institutional client may negotiate a fee discount from an investment adviser, and thereafter, the client may refer another institution to the investment adviser. We do not believe that there is a valid regulatory interest in categorizing the institutional client as a paid solicitor.

- An investment adviser may market its products to a private bank, and then train the bank's staff on its strategy or take the bank staff to dinner. We similarly do not believe that there is a regulatory interest in categorizing the private bank as a paid solicitor.

- An investment adviser may organize a training session on its investment strategies for an investment consultant with a shared client, and thereafter, the investment consultant may recommend an investment with the investment adviser to the shared client. We do not believe that there is a regulatory interest in categorizing the investment consultant as a paid solicitor. In fact, it would be inappropriate to do so, because the investment consultant is operating as an agent of the shared client and not on behalf of the investment adviser.

The foregoing practices occur frequently and the Proposed Solicitation Rule threatens the ability of these practices to continue due to the rule's unduly vague treatment and broad inclusion of both cash and non-cash compensation.

Therefore, the Associations respectfully submit that the Commission should not change the scope of the Current Solicitation Rule, and instead should subject only cash consideration to the rule. We believe that non-cash consideration should remain subject to the flexible protections afforded by various anti-fraud rules, whether under the Advisers Act, applicable broker-dealer rules, or similar laws and regulations.

1.2.2 Eliminate expansion to solicitation of private fund investors.

The Associations question the proposed withdrawal of the 2008 "Mayer Brown" no-action letter[15] and the attendant extension of the Proposed Solicitation Rule's scope to solicitation of private fund investors. The Commission's approach under the Mayer Brown No-Action Letter relies on well-reasoned legal principles, and as far as we are aware, both investment advisers and solicitors have relied on this letter without issue or the meaningful deterioration of protections in relation to the solicitation of private fund investors.

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[14] Proposed Rule Release, *supra* note 3, at 67572.

[15] Mayer Brown LLP, SEC Staff No-Action Letter (July 28, 2008), available at https://www.sec.gov/divisions/investment/noaction/2008/mayerbrown072808-206.htm (the "**Mayer Brown No-Action Letter**").

As a result, the Associations are puzzled by this initiative and uncertain about the perceived need for further regulation. We observe, moreover, that in many cases the solicitor involved would be a third-party broker-dealer regulated under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), and related rules adopted by the Commission and the Financial Industry Regulatory Authority, Inc. ("**FINRA**") (or in the case of marketing to non-U.S. investors, similarly regulated under applicable non-U.S. regulations). In the U.S., regulated solicitors are already subject to detailed conflicts mitigation and disclosure requirements, making the application of the Proposed Solicitation Rule to such relationships duplicative. Rather than reverse the Mayer Brown No-Action Letter as contemplated under the Proposed Solicitation Rule, the Associations recommend that the Commission codify the letter's sensible approach in any final version of the solicitation rule.

II. SPECIFIC COMMENTS ON THE PROPOSED ADVERTISING RULE

2.1 The broad sweep of the definition of "advertisement" combined with the narrowness of the delineated exemptions threaten to chill the flow of information to investors.

2.1.1 <u>Failure to include the exception under the Current Advertising Rule for one-on-one communications is problematic.</u>

The Associations appreciate the Commission's desire to respond to evolving industry practices by proposing a new definition of "advertisement".[16] We also welcome the related changes to the definition that would allow it to be evergreen in the face of future technological developments. However, eliminating the current exception for communications with a single person makes the proposed definition unworkable.

The proposed definition would unjustifiably expand the scope of the definition beyond a plain-language understanding of the term and would capture ordinary-course commercial relationships and communications.[17] In response, investment advisers would likely curtail the number of communications disseminated to clients or investors and/or decrease the amount of detail

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[16] The proposed definition of "advertisement" encompasses "any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser's investment advisory services or that seeks to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser". Proposed § 275.206(4)-1(e)(1).

[17] It is for exactly these reasons that other related frameworks for regulating communications incorporate *de minimis* or "ordinary-course" exceptions. Under FINRA Rule 2210(a)(2), "Correspondence" means "any written (including electronic) communication that is distributed or made available to 25 or fewer retail investors within any 30 calendar-day period". FINRA Rule 2210(a)(2) (2019), available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210. FINRA's approach is further discussed below. NFA has similarly interpreted NFA Rule 2-29 to "distinguish routine day-to-day communications with customers [from 'promotional materials'] and [to] appl[y] a different regulatory standard to such communications". In the relevant interpretive notice, the NFA explains that "this [distinction] is accomplished by providing a definition of 'promotional material' to identify the kinds of communications with the public that will be subject to specific content standards . . . Therefore, the definition of promotional material is intended to include all kinds of promotional communications with the public, other than routine day-to-day contact with customers". NFA Interpretive Notice 9003, NFA Compliance Rule 2-29: Communications with the Public and Promotional Materials (Nov. 19, 1985; revised July 24, 2000, Jan. 1, 2020), available at https://www.nfa.futures.org/rulebook/rules.aspx?RuleID=9003&Section=9 ("**NFA Interpretive Notice**").

provided, reducing the flow of information to clients and investors.[18] Therefore, the Associations respectfully urge the Commission to retain the existing exception for communications to a single person from the definition of "advertisement".

We also respectfully point out that FINRA's corresponding advertising rule, which applies to virtually all Commission-registered broker-dealers, maintains a distinction between correspondence (defined as any communication disseminated to fewer than 25 retail investors) and various categories of advertisements (which are distributed to larger audiences).[19] This standard has proven workable for the broker-dealer community. We likewise note that the approach of the National Futures Association ("**NFA**") effectively exempts routine day-to-day communications with customers.[20]

Therefore, another option would be for the Commission to adopt a *de minimis* standard that is consistent with the FINRA and NFA approaches. Such an approach, among other potential benefits, would harmonize standards for investment advisers that either are directly subject to these other regulations or are affiliated with firms operating under those standards. Employing common U.S. regulatory standards would provide greater clarity and allow affected market participants' compliance departments to implement efficient and consolidated procedures. It also would allow clients and investors to rely on similar levels of expected communication and transparency from their investment advisers, broker-dealers, commodity trading advisors, and commodity pool operators.

2.1.2 <u>Extending the definition of "advertisement" to include communications "by or on behalf of" an investment adviser makes the definition overly broad and would reduce the quality and amount of information available to clients and investors.</u>

The Commission states in the Proposed Rule Release that it seeks to subject content disseminated by third parties to the same standard as content disseminated directly by investment advisers.[21] While standardization can be a laudable goal, we believe this approach unnecessarily expands the obligations of investment advisers to supervise the work of third parties, including third-party media publications and platforms. It further fails to account fully for the fact that an investment adviser's involvement with third-party communications can range from limited and cursory to full collaboration.

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[18] The potential consequences of the broad definition of "advertisement" are more acute when considered in conjunction with the mandated pre-use review and approval also proposed by the Commission (and to which we also strongly object, as discussed further below). In combination, the two elements would impose significant compliance costs on investment advisers and would directly jeopardize their ability to provide high-quality, high-touch service to investors.

[19] *See* FINRA Rule 2210, available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210. Section (a)(2) defines correspondence, section (a)(3) defines institutional communication, and section (a)(5) defines retail communication.

[20] *See* NFA Interpretive Notice, *supra* note 18.

[21] *See* Proposed Rule Release, *supra* note 3, at 67524; *see also* Proposed § 275.206(4)-1(e)(1).

As a result, the proposed standard would create a daily challenge for investment advisers to assess accurately their obligations, with constant risk of hindsight liability. For example, such hindsight liability could arise with respect to the following:

- Fact checking a third party's piece;
- Interacting with the press in the ordinary course (both on background and otherwise), including with respect to market commentary, regulatory developments, industry news, business developments, personnel, and performance; and
- Engaging with industry publications for the purpose of awards consideration.

In each case, under the Proposed Advertising Rule, investment advisers and third parties would be incentivized to distance themselves from each other's content and processes. The net impact would be a highly undesirable reduction in the quality and amount of information available to clients and investors about investment advisers, especially if investment advisers abandon fact-checking exercises and restrict their interactions with the press.

More fundamentally, the Associations disagree with the Commission's proposed approach here because it effectively ignores the differences among the parties involved. As proposed, investment advisers could be required to supervise content designed for audiences that might be several tiers of connection removed from the investment advisers themselves. For example, when a fund-of-funds platform invests in a private fund, to facilitate its own fundraising efforts, it is common for the fund-of-funds platform to ask the private fund's investment adviser to fact check a presentation that, among other things, includes discussion of the fund managed by the investment adviser. However, due to the Proposed Advertising Rule, the investment adviser would be incentivized to decline the fact-checking request to avoid the regulatory scrutiny that would attach.

In our view, while such an outcome would perhaps be a logical response to the regulatory requirements under the Proposed Advertising Rule, it is contrary to the very goals underlying the rule specifically and the securities laws more generally, because it would result in investment advisers making less information available to clients and investors. The Associations do not believe such responsibility should lie with an investment adviser where there is no direct relationship between the investment adviser and the underlying recipient, and where the investment adviser is not in privity with the recipient from a fiduciary, contractual, or other perspective.

It also seems clear that merely providing content to a third party, which the third party then incorporates in some form into its own third-party material, should not sweep the entirety of the resulting third-party material into the scope of the Proposed Advertising Rule. For instance, a third party could ask an investment adviser to provide fact sheets about itself or its products that the third party would use in part or in full (at the third party's sole discretion) in its own advertising materials. We believe the Proposed Advertising Rule should not capture this third-party material, even if the investment adviser knows or has reason to expect that the third party would use the original content that the investment adviser provided as such an input. Although in such case the investment adviser submitted content to the third party, when the resulting third-party material is considered as a whole, it typically cannot be said that the investment adviser "has involved itself in the preparation of the information or explicitly or implicitly endorsed or approved the information".[22] For the Proposed Advertising Rule to treat the investment adviser's role otherwise would significantly alter the relationship between the investment adviser and the third party and mandate a level of oversight and control by the investment adviser at odds with ordinary commercial expectations.[23]

To address our concerns, the Associations propose that the Commission eliminate the proposed "by or on behalf of" language from the final rule, due to the practical problems and ambiguities it creates as discussed above. In the alternative, the Associations request that the Commission adopt a standard similar to FINRA's approach, which is one of "entanglement" (*i.e.*, looking at whether the FINRA member through its conduct adopted or endorsed the third party's statement).[24] If the Commission adopts a standard based on the FINRA "entanglement" standard, we would also request that the Commission confirm that an investment adviser providing limited information that a third party later distributes or incorporates into third-party materials would not: (i) result in those materials being "by or on behalf of" the investment adviser; or (ii) by itself, constitute endorsement by the investment advisers of the third party's later materials.

2.1.3 <u>The expansion of the definition of "advertisement" to communications that "offer or promote" the investment adviser's services may introduce confusion or concern about what materials are promotional in nature and curb the flow of information to clients and investors.</u>

The Commission stated that it added the phrase "offer or promote" to the proposed definition due to its belief that advertisements are generally "promotional" materials.[25] The Associations do not fully share this view and believe that the focus of the Proposed Advertising Rule should be only on the regulation of communications specifically intended to offer an investment adviser's services.

The more amorphous concept of "promotion" potentially extends the rule to an unnecessarily large share of an investment adviser's regular communications. For example, it could include: (i) communications that provide information about the services that an investment adviser is already rendering to the client or investor, (ii) general communications relating to the investment adviser's business, and (iii) an investment adviser's terms of services or a relationship summary sent by an investment adviser to an existing client or investor. We believe that the Commission should make a distinction between advertisements aimed at offering a product or service and communications to clients and investors that provide information about an ongoing service. This

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[22] Proposed Rule Release, *supra* note 3, at 67524.

[23] We also note that these third parties often are regulated entities themselves, subject to their own content standards and fiduciary or other obligations to the clients and investors involved. Thus, regulatory protections already exist to protect adequately clients and investors without employing the strained approach embedded in the Proposed Advertising Rule.

[24] *See* FINRA, Guidance on Blogs and Social Networking Web Sites, Regulatory Notice 10-6 (Jan. 2010), available at https://www.finra.org/sites/default/files/NoticeDocument/p120779.pdf.

[25] *See* Proposed Rule Release, *supra* note 3, at 67525; *see also* Proposed § 275.206(4)-1(e)(1).

latter category of materials should not come within the scope of definition of an "advertisement". Therefore, we request that the Commission clarify that it such materials are not captured in the definition of "advertisement".

We are especially concerned about the treatment of any material containing market commentary as an "advertisement", as the Commission discusses in the Proposed Rule Release.[26] Market commentary designed for clients and investors is an essential element of ongoing client service and communication, which additional regulation would negatively affect. We also are concerned that an expansion of the definition of "advertisement" to include reporting materials sent to one or more existing clients or investors would create a significant burden on an essential element of client or investor service that allows investment advisers to provide transparency and relevant disclosure.

Therefore, the Associations recommend that the Commission eliminate the term "promote" from the final definition of "advertisement". In the alternative, should the Commission decide to retain the term "promote" in the final definition, we request that the Commission clarify that the inclusion of that term does not expand the definition of "advertisement" beyond its meaning under the Current Advertising Rule. We also ask that the Commission provide guidance in the final rule release clarifying that the following communications are excluded from the scope of the rule:[27]

- Commentary that does not reference the investment adviser's investment products or services, such as market, industry, or regulatory commentary or news;

- Job postings or similar publications offering employment, or seeking vendors or contractors;

- Prospectuses, preliminary prospectuses, term sheets, offering memoranda, or private placement memoranda;

- Communications sent solely to an investment adviser's existing clients or investors or to prospective clients or investors upon their specific request, such as risk reports, portfolio updates, and investor newsletters;

- General announcements relating to an investment adviser's personnel, philanthropic activities, firm awards, or general business developments;

- Interviews or firm profiles conducted by a third-party media publication that are not focused on offering an investment adviser's products or services;

[26] *See id.* at 67526.

[27] In most cases, in the view of the Associations, the communications described in the following list would not "offer or promote" an investment adviser's services and the Commission should appropriately exclude them on that basis. Regarding prospectuses, term sheets, and fund offering memoranda, these materials are not commonly viewed as regulated "advertisements" today in light of the separate overlay of regulation under the Securities Act of 1933, as amended (the "**Securities Act**"). The Associations believe carrying that practice forward under any final rule is likewise appropriate.

- Awards submissions;

- Press releases unrelated to any specific product or offering that are broadly disseminated, or that are disseminated solely to members of the media;

- Informational documents sent to clients and investors regarding their existing arrangements with the investment adviser, such as terms of service or relationship summaries; and

- Reprints of articles published by unaffiliated persons, provided that the investment adviser has not materially altered its content other than to correct factual errors, add disclaimers, redact statements that would make the reprint inconsistent with applicable regulation or otherwise to make the reprint consistent with applicable regulatory standards.

2.1.4 The exclusions from the definition of "advertisement" are narrow in scope and fail to provide necessary relief to investment advisers given the definition's breadth.

The Proposed Advertising Rule provides two exclusions from the definition of "advertisement", which relate to: (i) live oral communications that are not broadcast; and (ii) certain communications by an investment adviser that do no more than respond to an unsolicited request for information.[28] While on a plain reading of the language both exclusions would be helpful to investment advisers, the Associations are concerned that the discussion around the exclusions in the Proposed Rule Release make them of limited applicability and utility as discussed further below.

2.1.4.1 The proposed scope of the live oral communications exclusion is both ambiguous and overly narrow.

The Associations are concerned with the practical implications of the proposed scope of the live oral communications exclusion.[29] Creating a distinction between communications that are "broadcast" versus "non-broadcast" raises a number of important questions about permitted interactions with the press and on social media, as detailed in Sections 2.1.2 and 2.1.3 above. We feel strongly that the Commission must permit investment advisers to engage with third-party media in the ordinary course without every communication becoming an "advertisement".

First, in the Proposed Rule Release, the Commission indicates that storyboards and any other written material used by investment advisers to prepare for a client or investor presentation would not benefit from the exclusion.[30] Such a narrow view of the exclusion could hamper the ability of investment advisers to deliver live oral presentations due to concerns that a speaker's written notes and other preparatory materials would be an "advertisement". We similarly are concerned that preparation outlines and other materials that an investment adviser brings to a presentation, but does not actually show to the counterpart, would be considered advertisements subject to the Proposed Advertising Rule. We also note that the discussion around the proposed

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[28] Proposed §§ 275.206(4)-1(e)(1)(i)–(ii).

[29] Proposed § 275.206(4)-1(e)(1)(i).

[30] *See* Proposed Rule Release, *supra* note 3, at 67528–29.

exclusion implies that conceivably even presentation note cards would be subject to the pre-use review and approval mandate and would be required to contain performance disclosures. We are certain that the Commission does not intend these outcomes.

Second, with respect to the proposed exclusion for live oral communications, the Associations are uncertain what the technical elements are that determine whether a communication is "live". What degree of time delay and editing converts a communication from "live" to "not live"? How might a translation program affect that judgment? More broadly, does the live broadcast of an event where slides or other written materials are used constitute an "advertisement"? Alternatively, would the live broadcast or re-broadcast of an event without slides or other written materials still be considered an "advertisement"? If not, does this treatment change if the investment adviser produces a transcript, or if the investment adviser prepares and/or makes available closed captions? As a result, the Associations encourage the Commission to include guidance in the final rule release that makes it clear that what constitutes a "live" communication is to be understood flexibly in light of both the present context and the continued evolution of the media and technology involved.

Lastly, the Associations see ambiguity in the reference to "broadcast" versus "non-broadcast". In particular, in the Proposed Rule Release, the Commission provides an example that distinguishes between a live presentation on the internet that is "available to the general public" versus "available only to one person or a small group of people invited by the adviser".[31] In this example, it is unclear whether a quarterly conference call for client and investors organized by a chief investment officer or a portfolio manager would be considered a "broadcast" event that is an "advertisement", such that the conference call would be subject to the Proposed Advertising Rule. While there might be more than a small number of participants on such a conference call, such participation would not be broad enough to constitute participation by "the general public". Rather, their participation on the call would be by invitation only and contingent on their pre-existing relationship with the investment adviser or its funds. Thus, the Associations encourage the Commission to reconsider this specific guidance in the Proposed Rule Release, and in the final rule release, make it clear that such activities are within the proposed exclusion so as not to discourage these kinds of interactions.

2.1.4.2 The Commission should permit investment advisers to provide performance information as part of their response to unsolicited requests from clients and investors.

The Associations support the Commission's proposed exclusion from the definition of "advertisement" for responses to direct client or investor requests.[32] However, we are concerned by the fact that under the Proposed Advertising Rule this exclusion would not be available when the unsolicited client or investor requests are for performance information (*i.e.,* any performance information in the case of a "Retail Person"; only "hypothetical performance" information in the case of a "Non-Retail Person").[33] We similarly are concerned that this exclusion would not

[31] *Id.*, *supra* note 3, at 67528.

[32] Proposed § 275.206(4)-1(e)(1)(ii).

[33] The exclusion from the "advertisement" definition for unsolicited requests carves out: (A) any communication to a retail person that includes performance results; or (B) any communication that includes "hypothetical performance". Proposed §§ 275.206(4)-1(e)(1)(ii)(A)–(B).

apply if the investment adviser responds to the request for information with additional contextual information that the client or investor did not specifically include in its request.

The Associations feel strongly that the Commission should permit investment advisers to respond to all unsolicited client or investor requests without such a request being deemed an "advertisement". It would be contrary to the needs and natural expectations of clients and investors if regulations, instead of the scope of the request itself, shaped an investment adviser's response to a direct client or investor request, including where such request pertains to performance information.[34] Such a limitation would dramatically alter the investment adviser-client relationship and be an overly prescriptive restriction on an investment adviser's ability to service its clients and investors. Further, as all communications between investment advisers and their clients and investors are subject to anti-fraud protections, we respectfully submit that such protections are a sufficient check on inappropriate conduct without regulation of every such interaction as an "advertisement".

To the extent that the Commission decides not to permit investment advisers to respond to all unsolicited requests without the response being treated as an "advertisement", we request that the Commission provide guidance in the final rule release clarifying that an investment adviser's response to an unsolicited request from a third party that contains performance information fits within the exclusion. In the experience of the Associations, many financial intermediaries, platforms, and consultants that would fit within the definition of "Non-Retail Person" frequently request information to evaluate whether an investment adviser's strategies or products are appropriate for their platforms or clients. Therefore, we think that the Commission should clarify that investment advisers may respond to such requests without the response being considered an "advertisement".

In addition, the Associations are concerned that the exclusion requires that a response to an unsolicited request be unduly narrow, responding only to the specific question asked and providing supplemental information only if "necessary" to make the response not misleading.[35] Under current practice, it is common for a client or investor to make an unsolicited request for an investment adviser to provide performance information for an account over a specific period. In such a scenario, we believe that the proposed exclusion should permit the investment adviser to respond with both the specific information requested as well as with additional context such as additional relevant time periods or closely related risk metrics. Receiving such additional information is important to client and investors, because it provides useful context and explanation, and we do not believe that the Proposed Advertising Rule should place the burden on client or investors to ask for that information before the investment adviser can provide it. Therefore, the Associations recommend that the Commission expand the scope of the exclusion

[34] Regarding the Commission's concerns with unsolicited requests for performance information (including "hypothetical performance" information), the Associations observe that these requests often are intended to directly match the specific analytical requirements, internal policies and procedures, or commercial considerations of the requesting client or investor, such as allowing for efficient side-by-side comparisons of different investment advisers, products, or variations on products. Therefore, responding to such requests in the form required and without undue delay serves important investor interests. Furthering the interests of clients and investors certainly should inform the Commission's considerations here.

[35] Proposed Rule Release, *supra* note 3, at 67530.

to allow an investment adviser to provide supplemental information in response to an unsolicited request, if the investment adviser determines "in good faith that the information is reasonably related" to the request. We believe that this modification is necessary to ensure that the proposed exclusion is not overly narrow and permits investment advisers to provide illuminating and complete answers in response to unsolicited requests.

Regarding the Commission's specific proposal to carve "hypothetical performance" information out of this exclusion (regardless of the sophistication of the audience), we refer to our more detailed discussion in Section 2.6.3 below on "hypothetical performance". The Associations strongly advocate for a more nuanced and thoughtful consideration of the risks presented by different categories of "hypothetical performance" and recommend that the Commission consider them in tandem with the elements of this proposed exclusion. "Hypothetical performance" information is a routine component of what sophisticated clients and investors, financial intermediaries, and their representatives request and expect from investment advisers. Thus, treating all investment adviser responses to unsolicited requests from a client or investor (even for a Non-Retail Person) as an "advertisement" because the response contains "hypothetical performance" information would be a material change in current industry practice. Such a change would bring a large universe of material into the definition of "advertisement", with the attendant costs, operational burdens, and intrusion on the ability of investment advisers to respond quickly and directly to requests from clients and investors.

2.2 The Commission should draw the distinction between a "Retail Person" and a "Non-Retail Person" differently.

Under the Proposed Advertising Rule, both "qualified clients"[36] and "accredited investors"[37] would be classified as a "Retail Person".[38] Given the recent Commission proposal specific to accredited investors,[39] such classification strikes us as incongruous, and the Associations encourage the Commission to include "qualified clients" and "accredited investors" within the definition of "Non-Retail Person".

Recently, the Commission proposed amendments to the "accredited investor" definition with the objective of expanding the term to encompass a greater number of institutional and individual investors.[40] The Commission stated that, in doing so, it is seeking to increase investment opportunities and expand access to private capital markets to investors previously denied these opportunities under the current criteria for accredited investor status.[41] Similarly, an interest in expanding investor access and choice also appears to us to be implicit in the Commission's Private Offering Concept Release.[42]

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[36] As defined in 17 C.F.R. § 275.205-3(d)(1) under the Advisers Act.

[37] As defined in Rule 501(a) of Regulation D under the Securities Act.

[38] Proposed § 275.206(4)-1(e)(14).

[39] *See* Accredited Investor Release, *supra* note 12.

[40] *See id*.

[41] *See id.* at 2574.

[42] *See* Private Offering Concept Release, *supra* note 11.

We are puzzled, therefore, by the Commission's statements in the Proposed Rule Release that qualified clients and accredited investors should be treated differently from "qualified purchasers",[43] on the theory that the former do not have access to resources to perform independent analysis and to consider performance information without the additional information required to be provided to a "Retail Person".[44] In fact, in the Accredited Investor Release, the Commission states unambiguously that it expects accredited investors to "have the resources and financial sophistication to assess private investment opportunities, despite the fact that these investments may have unique risk profiles and limited disclosure requirements".[45] Likewise, the Commission said there that "as accredited investors are presumed to be financially sophisticated, we anticipate that they would have the experience, resources, and incentives to screen private offerings".[46]

Accordingly, we encourage the Commission to continue to empower qualified clients and accredited investors, rather than to place limits on them. In our view, limiting client and investor information would reduce client and investor access to investment services and products and related opportunities.

The Associations also are concerned that the Commission's proposed distinction between a "Retail Person" and a "Non-Retail Person" presents the risk of a broad imbalance in how investment advisers prepare and disseminate information. If too many clients and investors are swept into the definition of "Retail Person" and are deemed to require special protection (as the Commission is proposing), then we think there are two likely outcomes. One outcome is that investment adviser would draft their advertisements for the largest audience, and thus, eliminate content useful to many sophisticated clients or investors. The other potential outcome is that certain investment adviser communications would contain deep and tailored content that would be available only to a small group of sophisticated investors with the most significant resources. We think each outcome is problematic and represents a disservice to many clients and investors.

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[43] As defined in 15 U.S.C. § 80a-2(a)(51). In this regard, we think it important to note that there are limited instances when a qualified institutional buyer under Rule 144A, 17 C.F.R. § 230.144A(a)(1), is not also a qualified purchaser. While the Associations strongly agree that the Commission should include qualified purchasers in the definition of "Non-Retail Person", we also believe that the final rule should include all qualified institutional buyers within the definition of "Non-Retail Person".

[44] *See e.g.*, Proposed Rule Release, *supra* note 3, at 67548–49, 67563.

[45] Accredited Investor Release, *supra* note 12, at 2600.

[46] *Id*. at 2607. While the Private Offering Concept Release and the Accredited Investor Release understandably devote most of their attention to the sophistication and abilities of accredited investors, the Associations see no reason not to extend the same logic to consideration of "qualified clients" under the Advisers Act, especially as the Commission has previously recognized their sophistication and abilities in prior releases. The Commission has long deemed "qualified clients" as "financially sophisticated" or as "hav[ing] the resources [available] to obtain sophisticated financial advice regarding the terms of [performance fee] arrangements". Exemption to Allow Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client Account, 63 Fed. Reg. 39022, 39022 (July 21, 1998), available at https://www.govinfo.gov/content/pkg/FR-1998-07-21/pdf/98-19373.pdf. Thus, "because of their wealth, financial knowledge, and experience", those falling into the category of "qualified clients" have been "less dependent on the protections provided by the Advisers Act's restrictions . . ." *Id.* at 39023.

Therefore, the Associations respectfully urge the Commission to include "qualified clients" and "accredited investors" within the definition of "Non-Retail Person" to ensure proper classification of all sophisticated clients and investors, harmonize the final rule with the Commission's thinking in other releases, and continue to require that retail clients and investors receive the additional protections that a "Retail Person" would be afforded under the Proposed Advertising Rule.

2.2.1 The distinction between a "Retail Person" and a "Non-Retail Person" would be difficult to determine in practice, as investment advisers often do not have sufficient information about clients and investors to make a status determination at the time of marketing.

The Associations foresee a number of practical difficulties that would result from the Commission's proposed "Retail Person"/"Non-Retail Person" framework.

For example, as a matter of efficiency and privacy, clients and investors are often reluctant to provide investment advisers with detailed information about themselves before receiving introductory advertising materials. Under the proposed framework, such "pre-screening" often would not be an option because the Proposed Advertising Rule limits the information that an investment adviser can provide to a "Retail Person". Instead, if the client or investor wishes to be able to receive the broader scope of information that the rule permits an investment adviser to provide to a "Non-Retail Person", the client or investor would have to disclose sufficient information about themselves for the adviser to determine their "Non-Retail Person" status prior to the receipt of any introductory materials. Thus, even plainly sophisticated clients and investors might be treated as a "Retail Person" for a potentially extended period until the investment adviser has the information necessary to treat the prospect as a Non-Retail Person (*e.g.*, at times extending until nearly the moment that the investment adviser-client relationship is formalized).

The Proposed Rule Release acknowledges this issue, which is helpful, but the Commission's suggested solution is for investment advisers to rely on the existing "reasonable belief" standard.[47] In practice, that framework essentially requires investment advisers to obtain responses to detailed questionnaires and investor representations in advance of providing material that constitutes an "advertisement". However, in practice, investment advisers frequently have difficultly or are unable to obtain such completed questionnaires or representations in the time needed.

Therefore, instead of employing the "reasonable belief" standard, the Associations request that the Commission modify the proposed "Retail Person"/"Non-Retail Person" framework to provide a safe harbor that would permit investment advisers to satisfy this obligation using a more flexible standard based on "reasonable expectation". We think such a safe harbor is necessary to ensure that, where an investment adviser initially provides materials to a prospect that are authorized only for a "Non-Retail Person", the Commission would not later penalize

[47] *See* Proposed Rule Release, *supra* note 3, at 67547.

either the investment adviser or the prospect for their "reasonable expectation", if ultimately they determine that the prospect is a "Retail Person" for these purposes.[48]

As an aside, including qualified clients and accredited investors in the definition of "Non-Retail Person" as we recommend above would somewhat mitigate these practical issues. It often would be easier for an investment adviser to develop a preliminary reasonable expectation as to a prospect's net worth or income or the size of the person's investment portfolio.

2.2.2 The distinction between a "Retail Person" and a "Non-Retail Person" may give rise to problems related to inconsistent information, especially in the context of Section 3(c)(1) funds.

The Associations are concerned that another practical problem presented by the proposed "Retail Person"/"Non-Retail Person" framework is that investors participating in the same platform or in the same fund would be provided different information where some investors are a "Retail Person" and other investors are not. This dual information flow would result in a potential disadvantage and confusion on the part of the investors and their representatives as well as heightened compliance and operational burdens for the investment adviser.

In the context of private funds, this issue would be most stark for investment advisers that sponsor and advise Section 3(c)(1) funds. For some of these investment advisers, the expense and complexity of maintaining multiple funds can be challenging, and would be greatly increased by the Proposed Advertising Rule requiring them to produce two different sets of marketing materials or work with inconsistent information. We especially are concerned, therefore, that the proposed framework could dis-incentivize investment advisers from continuing to make Section 3(c)(1) funds available. To prevent this outcome, the Associations recommend that the Commission: (i) include accredited investors in the definition of "Non-Retail Person", (ii) provide a specific exception to the requirements for a "retail advertisement" where the fund being advertised is a Section 3(c)(1) fund that is offered side by side with a Section 3(c)(7) fund, or (iii) add a grandfathering provision to the final rule for current investors in vehicles that might face this issue.

2.2.3 The distinction poses challenges with respect to non-U.S. persons.

Another practical issue with the "Retail Person"/"Non-Retail Person" distinction is that as proposed it only takes into account U.S. securities law definitions. However, the investment management industry is global in nature, and many investment advisers service both U.S. and non-U.S. clients and investors. In the ordinary course, an investment adviser often has no cause to determine the qualified purchaser or accredited investor status of non-U.S. clients and investors.[49] Instead, investment advisers often evaluate non-U.S. persons according to the

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[48] In the same vein, one can imagine "cure" terms by which more detailed explanations are given as the prospect's needs are better understood (and no later than the time of investment).

[49] In the case of investors in non-U.S. funds, this situation in part reflects applicable guidance specifically allowing for their U.S. regulatory status to be disregarded. *See e.g.*, Touche Remnant & Co., SEC Staff No-Action Letter (Aug. 27, 1984); Goodwin, Procter & Hoar LLP, SEC Staff No-Action Letter (Feb. 28, 1997), available at https://www.sec.gov/divisions/investment/noaction/1997/goodwinprocterhoar022897.pdf.

adviser's own internal judgments on sophistication or, if applicable, by referring to local law sophistication standards.

Therefore, the Associations believe that, in the final rule, the Commission should recognize the different treatment of similarly sophisticated investors and clients under applicable U.S. and non-U.S. laws. Specifically, any final rule that the Commission adopts should allow investment advisers the flexibility to classify a non-U.S. person as a "Retail Person" or "Non-Retail Person" based on those existing practices, so long as the investment adviser makes those determinations in "good faith". We also believe the Commission should add a grandfathering provision with respect to current non-U.S. clients and investors, given that it is possible that, at the time of their original investment, no such "Retail Person"/"Non-Retail Person" distinction was even considered.[50]

2.2.4 The proposed requirement to prescribe specific performance presentation periods in a "retail advertisement" is unworkable for certain types of private funds (as well as incongruous with a principles-based approach to regulation of advertising).

The Proposed Advertising Rule includes a requirement that investment advisers must always include performance results for one-, five-, and ten- year periods when marketing to a "Retail Person".[51] This proposed requirement for a "retail advertisement" creates significant practical and operational complexity.

While similar timeframe requirements are standard for regulated mutual funds, the types of funds that are classified as private funds are significantly more varied in nature and cannot be as easily subjected to one-size-fits-all requirements. Indeed, for certain types of private funds, such as private equity funds, private credit funds, real estate funds, and other funds where the investment adviser cannot present the actual performance results until the end of life of the fund, the proposed requirement is unworkable.

In this regard, the Associations observe that overall the Proposed Advertising Rule is flexible as to how an investment adviser calculates and presents investment performance. Specifically, the rule implicitly, reasonably, and appropriately recognizes the diversity of products, services and audiences involved and recognizes that investment advisers and their clients and investors can responsibly address these types of issues. Against that backdrop, these highly prescriptive timeframe requirements stand out as incongruous and unnecessary.

Therefore, the Associations respectfully request that the Commission eliminate the standardized timeframe requirement. Eliminating the requirement would be consistent with the principles-based approach that the Commission is seeking to adopt, and it would offer investment advisers the flexibility to determine which timeframes for performance information furnished in a "retail

[50] The recommendations the Associations make in this paragraph principally address issues the Associations expect would affect U.S.-domiciled investment advisers in their dealings with non-U.S. persons. A registered investment adviser with its principal place of business outside the U.S. is not subject to either the Current Advertising Rule or the Proposed Advertising Rule with respect to its non-U.S. clients under the "Unibanco" line of no-action letters. *See e.g.*, Uniao de Bancos de Brasileiros S.A., SEC Staff No-Action Letter (July 28, 1992), available at https://www.sec.gov/divisions/investment/noaction/1992/uniaodebancos072892.pdf.

[51] Proposed § 275.206(4)-1(c)(1)(v).

advertisement" would be the most instructive given the product or service involved and overall context.

2.3 The Commission should simplify and streamline the "general prohibitions" in the Proposed Advertising Rule in favor of a core anti-fraud requirement consistent with the Current Advertising Rule.

2.3.1 <u>The "general prohibitions" appear redundant and are potentially confusing.</u>

The Associations have significant concerns with the Proposed Advertising Rule's "general prohibitions".[52] We believe that the approach in the Proposed Advertising Rule would lead to confusion, redundancy, and heightened risk that various elements of the rule would be ineffective or unduly burdensome in light of evolving practices and context. Thus, the Associations strongly recommend that the Commission eliminate the general prohibitions in favor of continued reliance on the simpler and clearer anti-fraud standard from the Current Advertising Rule.[53]

2.3.2 <u>Certain of the general prohibitions are prescriptive in nature rather than general or principles-based requirements.</u>

The Associations are concerned that a number of the general prohibitions are not principles-based, and instead are inflexible prescriptive requirements that could stifle useful and productive communication.

For example, one of the prohibitions is that an "advertisement" may not "include a material claim or statement that is unsubstantiated".[54] We are concerned that the proposed "substantiation" standard is both unduly prescriptive and ambiguous. Investment advisers and their compliance officers already review materials for compliance with anti-fraud and other requirements. However, under the Proposed Advertising Rule, they also would be compelled to confirm and document sufficient "substantiation" for every term used in communications. Therefore, the greatly increased cost and operational burdens associated with this requirement would undoubtedly curb the flow of information from investment advisers to clients and investors as investment advisers weigh the costs and burdens of the substantiation requirement against the utility of the desired communication. Moreover, a flat substantiation requirement is at odds with the need of investment advisers or third parties to be able to express opinions (*e.g.*, in a testimonial or endorsement in the case of third parties, or in market commentary in the case of investment advisers). In each case, the existing anti-fraud framework should be sufficient without the overlay of a new requirement.

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[52] Proposed § 275.206(4)-1(a).

[53] Commission Rule § 275.206(4)-1 ("(a) It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Act for any investment adviser registered or required to be registered under section 203 of the Act, directly or indirectly, to publish, circulate, or distribute any advertisement . . . (5) Which contains any untrue statement of a material fact, or which is otherwise false or misleading.").

[54] Proposed § 275.206(4)-1(a)(2).

Similarly, the Associations believe that the prohibition requiring any reference to an implied benefit to include a discussion of attendant risks would lead to the production of unwieldy, and potentially even unusable, advertising materials.[55] Specifically, we are concerned that the length of disclosures that accompany advertising materials would dramatically expand under this requirement. For example, a one-page fund overview is a document that investment advisers commonly use for advertising purposes. Under the proposed requirement, it appears that an investment adviser could be required to be accompanied by multiple pages of risk disclosure in this document, which would overwhelm the content of the document itself. As the Commission knows, it is industry practice to disclose risk factors in Form ADV and offering documents. Thus, requiring the same risk disclosure in such a short fund overview document would not seem to be of additional benefit to investors. While we agree that advertising by investment advisers requires balance, the Proposed Advertising Rule arguably establishes an "every benefit carries corresponding risk" standard, which would be overly prescriptive and ultimately might harm the ability of investment advisers to provide meaningful disclosure content.

In addition, such a specific risk disclosure requirement is inconsistent with the reality of how many private funds are offered. In general, investment advisers offer private funds through a comprehensive and layered approach that includes not only standalone fact sheets and marketing decks, but also a detailed private placement memorandum and often an online data room in which a broad range of ancillary material with respect to the fund is available for inspection. It is not reasonable to require each of these different source materials to have standalone risk disclosure. It is also not reasonable to treat every component of such a data room as an "advertisement", which again highlights the issues with the breadth of the proposed definition.

Therefore, the Associations suggest that the Commission eliminate the enumerated general prohibitions and, as we have recommended above, instead continue to rely on the simpler and clearer anti-fraud standard from the Current Advertising Rule.[56] Such an approach would be both consistent with a principles-based approach and with the Current Advertising Rule and would better allow the final advertising rule to remain evergreen.

However, in the alternative, if the Commission ultimately opts to incorporate a specific risk disclosure requirement, the Associations would recommend that the Commission provide further clarification as to the categories of communications that would necessitate the inclusion of risk disclosures and the level of disclosures contemplated. We note, for example, that while investment advisers already provide detailed risk disclosures in their Form ADVs, and such disclosures are a core component of fund private placement memoranda, those documents are longer and include more descriptions than most advertising materials. Requiring investment advisers to include detailed risk disclosures in all advertisements would risk overwhelming other content. Therefore, if the Commission retains the proposed risk disclosure requirement, to avoid redundancy, we ask the Commission to confirm that in most documents a cross-reference to the important risks outlined in those longer documents would suffice.[57]

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[55] *See* Proposed § 275.206(4)-1(a)(4).

[56] *See supra* note 53.

[57] In this regard, the Associations have specific concerns with the suggestions in the Proposed Rule Release that "hyperlinking" to risk disclosure is typically not sufficient. Proposed Rule Release, *supra* note 3, at 67533 (". . . it

2.4 While the proposal to permit the use of testimonials and endorsements is broadly positive and would foster more flexible and modern communications, the proposed provisions requiring diligence of third-party ratings place an undue burden on investment advisers.

The Associations applaud the Commission for permitting the use of testimonials and endorsements,[58] which would, among other important benefits, allow for greater social media interaction between clients and investors and their investment advisers. Thus, consistent with our understanding of the overall goals of the rulemaking, it would allow clients, investors, and the public to receive greater amount of information in more technologically up-to-date formats. We also support the Commission prohibiting investment advisers from providing inducements to third-party rating service or award providers in order to guarantee a particular outcome.[59] However, we recommend that the Commission clarify in the final rule release that mere payment of compensation, by itself, does not call into question a third-party assessment of an investment adviser.

Third-party rating organizations perform a valuable function in the investment industry by streamlining the initial assessment process, thereby creating efficiency of interaction for clients and investors and investment advisers. The Commission should allow such organizations to charge investment advisers for the services that they provide, as long as investment advisers do not pay for a particular outcome. In the absence of compensation from investment advisers, we assume that in many instances third parties would not provide such ratings, which would be to the detriment of clients and investors who consider such ratings as part of their investment decision-making process.

The Commission's proposed requirement to disclose compensation, including non-cash compensation, presents the same practical issues here that we highlight later in this letter in connection with the Proposed Solicitation Rule. The inclusion of non-cash compensation (or "non-cash benefits" as used in the Proposed Rule Release)[60] would add significant ambiguity to the scope of the disclosure requirement and would generally result in more confusion than utility in connection with disclosures made about a third-party rating.

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would not be consistent with the clear and prominent standard to merely include a hyperlink to disclosures available elsewhere"). A formulation like that commonly used today for registered investment companies, which urges an investor to consider carefully important risks, fees, and expenses before investing and then links to or explains how to obtain the requisite information, certainly would seem sufficient in most cases. For the Commission to take any other view would unfairly burden social media and online communications and favor traditional, paper-based advertising media (*e.g.*, where risk appendices, clear cross references to risk explanations, and similar approaches are routinely used). Given digital and online formatting constraints, the hyperlink often would be the most natural analog to those paper-based approaches. We also note that the Commission intended its newly adopted Form CRS to rely heavily on layered disclosure with use of specific references (*e.g.*, hyperlinks) and other cross-references to more detailed disclosure. Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33492 (July 12, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12376.pdf.

[58] Proposed § 275.206(4)-1(b)(1).

[59] Proposed § 275.206(4)-1(b)(2).

[60] Proposed Rule Release, *supra* note 3, at 67541.

Non-cash compensation disclosures also would cast uncertainty on the participation by investment advisers in events organized by third-party rating organizations. Consider an awards dinner and the common practice for award nominees and honorees to purchase event tickets or pay for program brochure announcements as part of the event. To treat those event tickets and programs as compensatory in nature is overreaching, but would be a consequence of the Proposed Advertising Rule as currently drafted.

In addition, the Associations are concerned with aspects of the Commission's proposed approach to third-party ratings that require investment advisers to conduct diligence on the rating process. A requirement to conduct diligence on the methodology of each third-party rating that an investment adviser intends to use would create significant challenges with limited benefits in our view. For example, investment advisers would be obliged to create new diligence processes. Thus, rating organizations might be overwhelmed by disparate inquiries conducted by dozens or scores of investment advisers, which would make rating organizations unwilling to cooperate. In our view, so long as the investment adviser is not paying for a guaranteed result and is otherwise engaging with a third-party rating agency in the ordinary course, such due diligence would not provide additional value to clients and investors, but would add significant burdens to both investment advisers and rating organizations.

The Associations also object to the proposed provision that would require investment advisers to retire third-party ratings and awards in response to changed business conditions.[61] An investment adviser's track record of received ratings and awards is part of its institutional legacy, and thus, it remains relevant and should be available for use notwithstanding later changed circumstances. Furthermore, investment advisers do not have the resources to monitor continuously the background and inputs provided to or used by every third-party rating organization, which is implicit in the Commission's proposed requirement. In addition, we believe that it is a rare occurrence that a change in circumstances so dramatic takes place as to present concern that the prior rating or award becomes materially misleading, and as such we believe such situations are already amply covered by the core anti-fraud standard, which we recommend for continued inclusion in the final rule.[62]

2.5 Allowing past specific recommendations (i.e., "specific investment advice" in the Proposed Advertising Rule) is a positive change that would facilitate investment advisers' ability to provide communications that are more responsive to investor expectations.

The Current Advertising Rule's prohibition on past specific recommendations has been a longstanding obstacle to investment adviser-client communications.[63] As a result, the Associations applaud the Commission's proposal to withdraw that prohibition because we believe that the ability to receive such information would positively contribute to a client's or

[61] *See* Proposed § 275.206(4)-1(b)(2); *see also* Proposed Rule Release, *supra* note 3, at 67542.

[62] If the Commission, nonetheless, concludes that there is a genuine issue here, presumably an investment adviser can address it by including the date on which a rating organization gave the rating or award.

[63] *See* Commission Rule § 275.206(4)-1(a)(2).

investor's understanding of an investment adviser's investment philosophy, processes, and approach.[64]

However, we are concerned with the Commission's discussion and positive statements in the Proposed Rule Release regarding the existing Commission staff no-action letters in this area.[65] Our view is that these letters are sensible, but also narrow and of limited utility in many circumstances. The Associations, therefore, request that the Commission clarify in the final rule release that these letters are only examples of safe harbors, and not the sole circumstances in which an investment adviser's presentation of past specific recommendations would be appropriate and permissible under the Proposed Advertising Rule.[66]

In this regard, the Associations believe that in cases where an investment adviser discloses total portfolio performance (*e.g.*, advertisements relating to funds), such disclosure is itself a sufficient measure to address the potential for investor confusion otherwise associated with highlighting individual positions or position results. In the ordinary course, clients and investors have access to total portfolio performance. Thus, it is difficult to imagine scenarios whereby it would be misleading to clients or investors if an investment adviser provides them with both total portfolio performance as well as the associated sub-components of it. Although the no-action letters cited in the Proposed Rule Release do not appear to recognize this point, it is certainly implicit in the Commission's discussion of "extracted performance", where the Proposed Advertising Rule would require using both the extracted performance and, for context, whole portfolio performance.[67]

2.6 While the Associations appreciate many aspects of the Commission's efforts to consolidate guidance relative to presentation of investment performance, we also offer various suggestions.

2.6.1 <u>The treatment of gross performance under the Proposed Advertising Rule is generally positive, but raises certain concerns, especially for new products where fees and expenses are not certain.</u>

The Associations welcome the Commission's proposed treatment of the presentation of gross fees and expenses,[68] which generally accords with current industry practice for advertisements directed at a "Retail Person" (*i.e.*, requiring gross and net performance to be displayed with equal prominence) and provides more flexibility for "non-retail advertisements" (*i.e.*, allowing gross performance only, subject to specific conditions).

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[64] We also observe that the Associations have had longstanding philosophical concerns with the concept of "past specific recommendations" in the context of the private fund business model, where the underlying investments cannot constitute "recommendations" to investors.

[65] *See* Proposed Rule Release, *supra* note 3, at 67602.

[66] *Id.* at 67558.

[67] *Id.* at 67558–59.

[68] *See* Proposed §§ 275.206(4)-1(c)(1)(i), (c)(2)(i).

We believe, however, that significant uncertainty would result from the application of the requirement that an investment adviser must provide, or offer to provide, a specific schedule of fees and expenses when it provides gross performance to a "Non-Retail Person".[69] For example, sophisticated clients and investors may expect to be involved closely in determining their fees and the range of expenses to which they would be subject. In such a circumstance, it may be both unwelcome commercially and potentially misleading for an investment adviser to provide the client or investor with a pre-determined schedule of fees and expenses. Therefore, the Associations request that the Commission explicitly clarify in the final rule release that an investment adviser has flexibility to develop the appropriate schedule in "good faith" consideration of the needs and sophistication of the clients or investors involved. In particular, when an investment adviser is dealing with a client or investor that expects to negotiate fees and expenses, the Commission should permit the investment adviser to tailor the schedule to respond to that client's or investor's expectation of customization.[70]

We also believe there is a perhaps unintended element to the Proposed Advertising Rule as drafted in that it appears to require the schedule of fees and expenses even when the investment adviser provides the corresponding net performance along with the gross performance.[71] If indeed intended, we would consider this requirement to be an inappropriate and unnecessary expansion on the current rule because, in our view, the provision of the net performance obviates the need for any schedule of expenses.

The Associations also are concerned about the impact of the proposal on advertising new products for which an investment adviser must estimate actual fees and expenses. In such circumstances, we note that simply carrying over fees and expenses from an existing account would sometimes not be most appropriate. For example, changes in market circumstances or differences in product structure or strategy (or even account size) may require different outcomes. In the same vein, an investment adviser may need to exercise significant judgment in considering whether and how to account for the effect of anticipated expenses associated with such inputs as leverage or derivatives. As a result, the Associations request that the Commission either establish clear expectations for the treatment of specific expenses or, as we recommended above, confirm that investment advisers have the flexibility to make these judgments in "good faith".

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[69] *See* Proposed §§ 275.206(4)-1(c)(1)(i); *see also* Proposed Rule Release, *supra* note 3, at 67550.

[70] In a recent AIMA research study, AIMA found that "[t]he hedge-fund manager-led product of the past is being replaced with more bespoke investment mandates, including co-investment, customised solutions and other value advisory services which best aligns investors' unique risk and return goals. Over half (53%) of all respondents [(of which there were 118 representing $440 billion in assets under management)] believe that customised solutions are crucial to driving closer alignment with their investors, a marked increase from the 14% of respondents who offered the same view in our 2016 study". AIMA, *In Harmony: How Hedge Funds and Investors Continue to Strike the Right Note in Aligning Their Interests*, (2019), available at https://www.aima.org/educate/aima-research/in-harmony.html.

[71] *See* Proposed § 275.206(4)-1(c)(1)(i) ("An investment adviser may not include in any advertisement any presentation of gross performance, unless the advertisement provides or offers to provide promptly a schedule of the specific fees and expenses . . .").

2.6.2 The proposed provisions regarding "Related Performance", "Portability of Performance", and "Extracted Performance" generally would be positive for investment advisers, clients, and investors alike.

The Associations support the Commission's proposed treatment of related and "ported" performance[72] as it appears to accord generally with existing industry practice and appropriately recognizes the value that clients and investors see in such performance presentations. We also support the Commission's determination to treat portability of performance solely as a matter for guidance within the Proposed Rule Release and agree that no specific elements of the rule need address it. However, we believe that it is important for the Commission to clarify that the various Commission staff no-action letters cited positively in the Commission's proposed guidance are only examples of safe harbors, and are not the sole circumstances when an investment adviser's use of related or ported performance would be appropriate.

In addition, the Associations strongly support the Commission's recognition of the benefits of related and extracted performance.[73] With respect to related performance, we generally agree with the principles as stated regarding the inclusion and exclusion of related portfolios.[74] However, in the funds context, the Associations believe that investment advisers need some flexibility to recognize a "flagship" fund for a given strategy and to treat that "flagship" fund as the sole related portfolio in many instances. In the view of the Associations, prospective investors generally are less interested in the results of the ancillary funds around that flagship portfolio and could find the additional information suggested by the Proposed Advertising Rule as more confusing than helpful. With respect to extracted performance, we agree with the Commission that it generally should require investment advisers to provide performance information based on both the extracted portfolio and the related full portfolio together.

2.6.3 The proposed treatment of "hypothetical performance" information conflates different types of performance with varying risk profiles and, as such, appears broadly inconsistent with the Commission's intended principles-based approach.

The Associations appreciate that the Commission recognizes that "hypothetical performance" is an important tool for clients and investors. MFA has long advocated, and AIMA agrees, that sophisticated clients and investors have strong and legitimate interests in receiving such information. Indeed, sophisticated investors and clients often request, and in many cases require, investment advisers to provide "hypothetical performance" to inform their understanding of both the weaknesses and strengths of the investment adviser's investment process and associated products and services. We also agree that this kind of information should be subject to explanatory disclosures. However, we are concerned by the categorization of multiple different kinds of performance information as "hypothetical performance", as well as the related prescriptive requirements. In addition, the Associations are concerned that the disclosure requirements associated with the use of "hypothetical performance" are overreaching and could

[72] *See* Proposed Rule Release, *supra* note 3, at 67566–67.

[73] *See id*. at 67556–59.

[74] *See* Proposed § 275.206(4)-1(c)(1)(iii).

require the disclosure of valuable confidential and proprietary information to the detriment of clients, investors, and investment advisers.

2.6.3.1 The proposed definition of "hypothetical performance" is overbroad and the associated disclosure requirements do not appropriately account for the risks associated with different types of "hypothetical performance".

As a threshold issue, the Associations question the Commission's inclusion of backtested, model, target, and projected performance under a single definition of "hypothetical performance"[75] when the risks associated with each vary significantly. For example, the risks associated with constructing a return stream by applying market data to a proprietary trading model (often referred to as backtested performance) are quite different from the risks associated with the simple adjustment of a return stream to account for higher leverage or a different base currency. Nevertheless, under the Proposed Advertising Rule, the same prescriptive disclosure requirements would apply. We believe that the differences among the many types of "hypothetical performance" warrant each undergoing a different regulatory analysis and being subject to different and appropriate explanatory disclosure requirements. Thus, the Associations believe that the Commission should modify the Proposed Advertising Rule to allow investment advisers to scale the scope of disclosures to the risk profile of the type of "hypothetical performance" information.

This scaling approach would allow an investment adviser, for example, to provide a more limited enumeration of risks regarding performance based on actual trading data (*e.g.*, a presentation that assumes the *pro forma* application of additional leverage or other quantifiable criteria). Likewise, a scalable approach[76] would appropriately treat target or expected returns[77] as different from backtested or model returns.[78] We strongly believe any proposition that cannot account for these important differences would be incongruent with the principles-based approach that the Commission is seeking to incorporate into the Proposed Advertising Rule.

However, we note that the following statement in the Proposed Rule Release appears wholly inconsistent with our recommended scaling approach: "[the Commission] believe[s] advisers generally would not be able to include 'hypothetical performance' in advertisements that are directed to a mass audience or intended for general circulation because such an advertisement would be available to all investors, regardless of their financial situation".[79] In our view, such a near categorical exclusion is inconsistent with a principles-based rule, which should result in a

[75] Proposed § 275.206(4)-1(e)(5).

[76] In addition to the above discussion, a scalable approach could further recognize differences in the medium and content in which an investment adviser uses "hypothetical performance". For example, "hypothetical performance" in a white paper or general "thought leadership" publication has meaningfully different risks and impact from the same information used to offer a particular product or service.

[77] Clients and investors regularly request target or expected returns, which are an investment adviser's forward-looking goals or projections that the fund or other product may or may not realize.

[78] Backtested or model returns are by their nature likely to be viewed as partial substitutes for past performance and thus as more confusing than targeted or expected returns.

[79] *See* Proposed Rule Release, *supra* note 3, at 67563.

more nuanced approach depending on the facts and circumstances. Given the broad nature of the proposed definition of "hypothetical performance", it includes various types of information that may well be appropriate for the public (such as performance targets or expectations).[80] Therefore, the Associations feel strongly that it is important to employ a principles-based approach and retain flexibility with respect to the use of "hypothetical performance" to ensure that the final advertising rule is evergreen and is consistent with the Commission's goal of moving away from the a prescriptive, one-size-fits-all approach of the Current Advertising Rule.

The Associations also ask the Commission to clarify that it has no implicit expectation under the Proposed Advertising Rule that an investment adviser would refer to each category of performance as "hypothetical performance" when presenting such materials to clients and investors. Use of the term "hypothetical performance" may or may not be appropriate, depending on the context.

2.6.3.2 <u>The disclosure requirements for "hypothetical performance" threaten valuable intellectual property and would harm clients, investors, and investment advisers.</u>

The Associations strongly urge the Commission to reconsider the disclosure requirements especially as it pertains to algorithmic-based, model-driven, and similar trading strategies. For these strategies, protecting an investment adviser's valuable intellectual property, which forms the basis of an investment adviser's competitive advantage, must factor into how an investment adviser presents the relevant explanations and assumptions. In this regard, the Associations are very concerned with the Commission's suggestion that disclosures accompanying "hypothetical performance" should allow clients and investors to "replicate" the performance provided.[81]

Taken literally, this statement could cause an investment adviser to have to contemplate two unacceptable options: (i) providing information that exposes key elements of the investment adviser's processes, and thus, threatens the investment adviser's strategic and competitive advantage; or (ii) refusing to provide "hypothetical performance" to safeguard its proprietary interests. Option one represents loss of valuable intellectual property and, as a result, dis-incentivizes design and investment in innovative trading strategies. We see no winner under that outcome because the investment adviser's franchise is damaged, and clients, investors, and the markets suffer from reduced choice, competition, and efficiency. We also do not see any positive outcomes under option two. Under this scenario, clients and investors lose access to information. The investment adviser's franchise is also harmed, but the harm arises from the difficulty investment advisers would have in describing and marketing their strategies. Thus, the Associations believe that it is critical that the Commission confirm that this level of disclosure is not what it expects or requires under the Proposed Advertising Rule.

On a related note, should the Commission adopt a version of the pre-use review and approval mandate, despite our strong opposition in Section 2.7 below, we would urge the Commission to provide exceptions from the pre-use review and approval mandate for advertisements that contain "hypothetical performance" information. In such cases, it would be critical for the

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[80] Such a statement also may have anticompetitive effects to the extent it completely chills otherwise creative and useful presentations for new investment products.

[81] Proposed Rule Release, *supra* note 3, at 67564.

Commission to provide exceptions that give investment advisers the latitude necessary to tailor compliance procedures to their own circumstances.

2.7 The mandated internal pre-use review and approval would be unduly burdensome and contrary to the established principle that each investment adviser should have the flexibility to establish internal procedures tailored to its own firm and needs.

The Associations wish to express significant concern with the Commission's proposed mandated pre-use review and approval requirements, particularly when combined with an expansion of the definition of "advertisement" under the Proposed Advertising Rule.[82] These requirements appear both structurally redundant to, and wholly at odds with, the flexible, principles-based approach of the Commission's current compliance program rule (Rule 206(4)-7 under the Advisers Act) and the Commission's stated objectives in the Proposed Rule Release.[83]

As to the proposed mandate's structural redundancy, the compliance program framework already requires oversight of the advertising function. The Commission explicitly stated when adopting Rule 206(4)-7 that it expects an investment adviser's compliance program to address "accuracy of disclosures made to investors, clients, and regulators, *including* . . . *advertisements*" (emphasis added).[84] Accordingly, investment advisers already must, and in practice do, exercise oversight of advertising activity in a manner that is reasonably designed to maintain compliance with the Current Advertising Rule for the benefit of the investment adviser's clients and investors.

As to the proposed mandate's lack of flexibility, we note that the Commission observed the following when adopting the compliance program rule: "funds and advisers are too varied in their operations for the rules to impose of a single set of universally applicable required elements. Each adviser should adopt policies and procedures that take into consideration the nature of that firm's operations".[85] The Associations feel strongly that the same principles should apply here. Unfortunately, the broad and sweeping pre-use review and approval mandate seems to ignore the importance of allowing an investment adviser to design its own compliance program in a reasonable manner, so that the adviser can facilitate compliance and protect client and investors. Further, application of the pre-use review and approval requirements to the expanded "advertisement" universe (which, as defined, could include many emails, call notes, reports, etc.) would be extremely and untenably burdensome.

Investment advisers would either need to expand their compliance programs at great expense by undertaking new staffing, training, third party support, technology, and recordkeeping, or the investment advisers would need to pare back significantly the communications on which clients and investors rely. Both of these options are harmful to clients and investors as well as investment advisers. Under the first option, the operational and cost burdens to investment advisers would be substantial. There would similarly be a burden on clients and investors

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[82] *See* Proposed § 275.206(4)-1(d).

[83] Commission Rule § 275.206(4)-7.

[84] Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Reg. 74714, 74716 (Dec. 24, 2003), available at https://www.govinfo.gov/content/pkg/FR-2003-12-24/pdf/03-31544.pdf.

[85] *Id.* at 74716.

because the speed of investment advisers' informational flow would be reduced due to the review procedures. Under the second option, clients and investors clearly would be harmed as less information about prospective or current investments would reach them. Meanwhile, investment advisers would necessarily have less interaction with clients and investors, likely impeding fundraising efforts.

The Associations also are concerned by language in the Proposed Rule Release suggesting that only "designated employees" may conduct contemplated pre-use reviews and approvals.[86] Such a requirement is unduly prescriptive in all cases, but carries special burdens for the many investment advisers (especially smaller investment advisers) that rely on third parties to review advertisements. If the Commission adopts the pre-use review and approval mandate as proposed, these investment advisers would be required to build an entire review program, which would be costly, unnecessary, and difficult to complete within the transitional period. Moreover, if the Commission were to adopt the mandate in modified form to account for the use of third parties, then such providers would likely raise their prices to benefit from the exponential increase in demand the Proposed Advertising Rule would generate.

For all of these reasons, we believe that adoption of such a pre-use review and approval mandate would represent a material and immediate compliance burden, carrying significant new costs and burdens for investment advisers (or for fund investors, to the extent such costs are a fund expense), and unintended harm to clients and investors. Accordingly, the Associations respectfully urge the Commission to reconsider its proposed approach and maintain the spirit of the existing compliance program rule (Rule 206(4)-7).

In the alternative, if the Commission chooses not to recognize and rely on the efficacy of its existing compliance program rule, the Associations request that the Commission clarify in the final rule release that it permits investment advisers to:

- Provide the same substantive response to several different clients or investors without subjecting each subsequent version of the communication to formal review processes as advertisements;
- Update figures and dates in existing documents without fresh reviews;
- Exclude purely ministerial communications (such as a cover email directing the recipient to an attachment);
- Exclude email communications with a single existing client or investor regarding their current investment(s);
- Exclude transmitting emails or other written correspondence that are incidental in nature and only summarize already approved content or materials, provided that the summary remains consistent with what appears in such content or materials; and

[86] *See* Proposed Rule Release, *supra* note 3, at 67669.

- Establish systematic processes that allow the investment adviser to draw on approved templates and text in "building block" fashion without each configuration being subject to additional re-review.

These proposed exclusions would benefit clients and investors in addition to easing the burden on investment advisers. For example, by allowing an investment adviser to review and approve a report template or standard presentation once, and thereafter use them multiple times with conforming or updating changes, the Commission would help facilitate better client and investor engagement in two important ways. First, clients and investors would have faster and more readily available access to information. Second, permitting such a streamlined process would support investment advisers' delivery of more uniform information.

While any pre-use review and approval mandate would be problematic for the reasons stated above, were the Commission to proceed with adoption of such a mandate, the Associations also strongly recommend that the Commission consider providing broad "class exemptions" to minimize the overall impact on investment advisers, clients, and investors. First, we would suggest that the Commission exempt "non-retail advertisements" from the pre-use review and approval mandate. Second, the Associations would also advocate for a carve-out for ordinary course communications aimed at those with significant institutional relationships with their investment advisers.

These relationships often develop between investment advisers and their clients and investors with broad involvement with different product, services, and departments of their investment advisers. In such cases, the pre-use review mandate would be especially burdensome on large firms that offer a variety of products to the same client or investor and which interact and communicate with their clients and investors through a number of departments. This carve-out also may be useful from a client and investor perspective as those clients or investors that maintain a deep relationship with their investment advisers generally would be sophisticated in nature, and thus, expect a constant flow of communication from their respective investment advisers. Therefore, if the Commission retains the pre-use review and approval mandate, the Associations recommend that the Commission include these exemptions along with others to lessen the burden of the mandate, and better align the proposed mandate with the principles under existing Rule 206(4)-7, which allow investment advisers to tailor their compliance program to their specific needs and processes.

2.8 The proposed additions to Form ADV may not achieve its intended purpose and would impose an additional compliance burden on investment advisers.

The Commission proposes to add supplemental questions to Form ADV in order to gather information regarding "Advertising Activities", including investment adviser practices with regard to performance results, testimonials, endorsements, third-party ratings, and prior investment advice.[87]

[87] *See* Proposed § 279.1, Part 1A; *see also* Proposed Rule Release, *supra* note 3, at 67649 ("Appendix A: Changes to Form ADV").

The Commission's desire to collect such information is understandable. However, we question whether the proposed approach would generate useful information for clients, investors, or the Commission. In practice, we expect that many investment advisers would likely answer that they rely on each form of "advertisement" listed in the supplemental questions to maintain flexibility in their advertising practices. As a result, the questions would not provide the Commission with accurate insight into investment advisers' actual advertising practices, and thus, would frustrate the core purpose of asking the proposed questions. Investment advisers also might feel hampered from expanding their advertising efforts during a given year because of the disclosure requirements in case such an expansion would make their advertising practices inconsistent with how they answered the relevant advertising questions on their last Form ADV.

Accordingly, the Associations believe that the associated costs imposed on investment advisers and the public of adding the supplemental questions significantly outweigh the marginal benefit (if any). Specifically, we do not see how clients, investors and other members of the public who are audiences to the online Form ADV would derive any benefit from the answers to the additional questions. As clients and investors are the recipients of the information to which the supplemental questions pertain, they would already know the answers to the questions about an investment adviser's advertising practices. Therefore, for clients and investors, the inclusion of the proposed questions would add to the unwieldy nature of Form ADV and inhibit efficient access to online information of genuine value.

The Associations also encourage caution with respect to adding questions to Form ADV solely as a tool for simplifying the examination procedures of the Commission's Office of Compliance Inspections and Examinations ("**OCIE**"). We believe that the Commission should balance any such use against the potential for changes to cause confusion and/or distract from the form's education and disclosure purposes. Therefore, the Associations recommend that the Commission not proceed with amending Form ADV to add the supplemental questions.

III. SPECIFIC COMMENTS ON THE PROPOSED SOLICITATION RULE

3.1 The expansion of the definition of "solicitor" to encompass the receipt of non-cash compensation is unworkable.

The Associations strongly believe that the Proposed Solicitation Rule should not apply to the receipt of non-cash compensation.[88] At the time of the Current Solicitation Rule's adoption, the Commission considered whether to extend the requisite forms of compensation to encompass non-cash compensation, but ultimately decided not to do so.[89] While the basis for the Commission's determination was not recorded in the original proposing or adopting release, we presume the choice stemmed from the Commission's recognition of the difficulty and

[88] *See* Proposed Rule Release, *supra* note 3, at 67572–73.

[89] *See* Requirements Governing Payments of Cash Referral Fees by Investment Advisers, 43 Fed. Reg. 6095 (Feb. 2, 1978), available at http://www.brightlinesolutions.com/files/Plaze/Release%20IA-0615%20Cash%20Referral%20Fees.pdf; Requirements Governing Payments of Cash Referral Fees by Investment Advisers, 44 Fed. Reg. 42126 (July 12, 1979), available at https://securities.utah.gov/docs/IA_Release_No-688_1.pdf.

impracticality of such an addition. Therefore, we believe that the Commission should carefully consider these issues once again before deciding to proceed as proposed.

Admittedly, some forms of non-cash compensation are more obvious than other forms.[90] The average investment adviser and solicitor likely would view directed brokerage relationships to be mutually compensatory in nature. However, many types of non-cash compensation enumerated in the Proposed Solicitation Rule are more ambiguous, including for example, training or education meetings, outings, and other forms of entertainment. The term "discounted advisory services" can be particularly problematic as investment advisers frequently vary or reduce advisory fees based upon several factors that are not directly related to any solicitation activity. Therefore, applying the Proposed Solicitation Rule in such a broad manner to such relationships as *quid pro quo* paid solicitation arrangements would be very problematic and make it difficult for all involved to know when or whether their activities might fall within the scope of the Proposed Solicitation Rule.

Due to such uncertainty, investment advisers and potential solicitors would have a constant challenge of accurately assessing their obligations under the Proposed Solicitation Rule. Moreover, the attendant risk and possible liability from incorrect assessments as to whether an arrangement is subject to the Proposed Solicitation Rule could negatively affect many ordinary-course and natural commercial activities that are beneficial to clients. Specifically, we would expect parties either to pull back from productive relationships unnecessarily or to adapt them imperfectly to the strictures of a rule that may or may not apply.

The Associations, therefore, respectfully request that the Commission retain the scope of the Current Solicitation Rule, so that only cash consideration is subject to the rule. Non-cash consideration would remain subject to the protections of the various fiduciary and anti-fraud rules, whether under the Advisers Act, applicable FINRA rules, or similar laws and regulations.

If the Commission nonetheless determines to proceed with the proposed scope, the Associations urge the Commission to narrow significantly the listed categories of non-cash compensation subject to the Proposed Solicitation Rule. At a minimum, the Commission should include only those forms that are easily identified and objective, thereby allowing certainty as to the application of the Proposed Solicitation Rule. Likewise, the Commission should consider thoroughly the risks and conflicts related to different types of non-cash compensation based on the facts and circumstances, rather than treating all non-cash compensation as equivalent. Some forms of non-cash compensation highlighted in the Proposed Rule Release rarely pose real conflicts,[91] such as training provided by an investment adviser to a bank or broker-dealer to ensure that its staff clearly understands a proposed investment strategy and its merits, risks, and context. These interactions are typical educational activities designed to minimize risk and benefit clients, and should not fall within the Proposed Solicitation Rule because the value of such non-cash compensation is difficult to quantify, and any conflict is minimal and far outweighed by the associated client and investor benefits.

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[90] The Commission's view of what would constitute non-cash includes "directed brokerage, sales awards or other prizes, training or education meetings, outings, tours, or other forms of entertainment and free or discounted advisory services". Proposed Rule Release, *supra* note 3, at 67573.

[91] *Id.*

As more fully discussed below, the Associations also request that the Commission consider narrowing the scope of the final rule to solicitors not already subject to regulation as investment advisers and/or broker-dealers under Commission rules. While a final rule that incorporates a non-cash compensation component applicable to any group of potential solicitors would leave significant uncertainty in application, narrowing the scope as recommended would still be a useful step towards a more workable rule. We further expect that the volume and variety of comments on this aspect of the Proposed Solicitation Rule may be sufficient that, if the Commission determines to proceed with a change in this direction, it should consider publishing a subsequent version of the rule for additional comment before concluding its rulemaking.

3.2 Reconsider withdrawal of the Mayer Brown No-Action Letter and expansion of the definition of "solicitor" to encompass those soliciting investors in private funds.

The Associations strongly object to the Commission's proposed extension of the Current Solicitation Rule to the solicitation of private fund investors,[92] effectively reversing Commission staff's 2008 Mayer Brown No-Action Letter.[93]

First, neither in the Proposed Solicitation Rule nor, to our knowledge, in past guidance has the Commission articulated any widespread issues or concerns associated with the existing rule.[94] Therefore, we are unclear as to what issues the Proposed Solicitation Rule is intended to address with respect to private funds.

Second, in the majority of cases where a solicited private fund investor is a "U.S. person",[95] the solicitor is a broker-dealer regulated under the Exchange Act and related rules adopted by the Commission and FINRA (with similar regulations generally applicable outside the U.S. as well). Regulated solicitors are already subject to conflicts and disclosure rules, making the application of the Proposed Solicitation Rule to those relationships unnecessarily duplicative in some instances and/or contradictory, and thus confusing, in others.

Finally, the Mayer Brown No-Action Letter is unambiguous that the Current Solicitation Rule "is designed so as to clearly apply to solicitations and referrals in which the solicited or referred persons might ultimately enter into investment advisory contracts with the investment adviser, yet investors in investment pools (as such) do not typically enter into investment advisory contracts with the investment advisers of the pools".[96] The Mayer Brown No-Action

[92] *Id.*

[93] *See* Mayer Brown No-Action Letter, *supra* note 15.

[94] While not dispositive, and while the relevant Commission staff said that their "Risk Alert does not address all deficiencies or weaknesses related to the Cash Solicitation Rule that have been identified by OCIE staff", we note that as recently as 2018 Commission staff published an alert addressing common deficiencies under the current rule without any indication that not covering fund investors was of concern. Commission Office of Compliance Inspections and Examinations, National Exam Program Risk Alert, Investment Adviser Compliance Issues Related to the Cash Solicitation Rule (Oct. 31, 2018), available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Cash%20Solicitation.pdf.

[95] As defined under Rule 902(k) of Regulation S of the Securities Act.

[96] Mayer Brown No-Action Letter, *supra* note 15.

Letter also cites the *Goldstein* decision[97] repeatedly for the proposition that an investment adviser-client relationship is substantively different from the (more attenuated) relationship that exists between a fund investor and the investment adviser to the fund.[98] The Mayer Brown No-Action Letter then effectively concludes that the general anti-fraud standards under Section 206 of the Advisers Act are sufficiently protective of such a relationship.[99]

Given the Commission's lack of explanation for its change in position, and that it fails in the Proposed Rule Release to refute or rebut the legal reasoning under the Mayer Brown No-Action Letter (including that letter's conclusion that general anti-fraud principles adequately address the relevant conflicts), the extension of the Proposed Solicitation Rule to solicitation of private fund investors appears to be unwarranted. Therefore, rather than reverse the Mayer Brown No-Action Letter as contemplated under the Proposed Solicitation Rule, the Associations recommend the Commission codify the letter's sensible approach in any final version of the solicitation rule.

The Commission also should consider that withdrawal of the Mayer Brown No-Action Letter could present a host of interpretive questions, for example, relating to the indirect solicitation of tiers of fund investors. The language of both the Proposed Solicitation Rule and Current Solicitation Rule are broad and encompass direct and indirect solicitation of clients.[100] However, the Proposed Rule Release does not clarify the scope or limits of such "indirect" solicitation, and fails to discuss what "indirect" solicitation means in the context of fund investors, feeder funds, funds-of-funds, and other fund structures.[101]

For example, if an investment adviser markets a fund that it manages to a fund-of-funds, and thereafter, provides training to the manager of the fund-of-funds, would the manager of the fund-of-funds be considered a paid solicitor of the investment adviser? While this result would be odd, the breadth and ambiguity of the rule does not foreclose such an interpretation. Therefore, if the Commission determines to proceed with the expanded scope of the Proposed Solicitation Rule and withdrawal of the Mayer Brown No-Action Letter, it would be critical for the Commission to confirm that the Proposed Solicitation Rule does not apply to such structures to prevent market confusion and provide certainty.

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[97] *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006).

[98] Mayer Brown No-Action Letter, *supra* note 15 (stating that "[i]n *Goldstein*, the court indicated that, for purposes of Section 206 of the Advisers Act, investors in a pooled investment vehicle are not 'clients' of the investment adviser of the pool" and "the court reasoned that the shareholders, limited partners, members or beneficiaries of such pools could not reasonably be considered to be 'clients' of the pools' investment advisers").

[99] *See id.*, *supra* note 15 ("Even if Rule 206(4)-3 does not apply to a particular situation, the soliciting/referring person may generally be required by Section 206 of the Act to disclose to the investor or prospective investor material facts relating to conflicts of interest . . . Section 206 requires investment advisers to disclose to their clients and prospective clients material facts relating to conflicts of interest.").

[100] Proposed § 275.206(4)-3(c)(4).

[101] *See* Proposed Rule Release, *supra* note 3, at 67571–74.

3.3 Eliminate the various redundancies and inflexible terms in the Proposed Solicitation Rule that were carried over from the Current Solicitation Rule.

In the Proposed Solicitation Rule, the Commission thoughtfully reassessed certain aspects of the Current Solicitation Rule that lead to redundancies and inflexibilities for investment advisers and solicitors. In particular, the Associations applaud the Commission's proposed elimination of the requirement that solicitors deliver a separate Form ADV brochure on behalf of an investment advisers for whom they are soliciting.[102] Investment advisers must already furnish such documentation to all prospective clients. Thus, the Current Solicitation Rule's requirement acts as an unnecessary compliance burden for solicitors and increases the amount of paperwork heaped on clients. Therefore, we strongly support the Commission's decision to make such an amendment in the Proposed Solicitation Rule.

Additionally, the Associations support the Commission's demonstrated commitment in the Proposed Solicitation Rule to providing measured flexibility for solicitors and investment advisers in meeting their compliance obligations. First, we appreciate the provisions that would allow either the investment adviser or solicitor to deliver the solicitor disclosure, rather than requiring the solicitor to deliver such forms.[103] Second, and as discussed in more detail below, we are grateful that the proposal moves from a "*bona fide* effort" standard[104] to a "reasonable belief" standard for investment adviser oversight of solicitors.[105] While below we raise some issues with the Proposed Solicitation Rule's discussion of the standard, we generally appreciate the Commission adopting a flexible and principles-based outlook on investment adviser and solicitor requirements in the Proposed Solicitation Rule. Therefore, as a general matter, we support the Commission's efforts to afford flexibility to regulated parties.

3.4 Exclude from the Proposed Solicitation Rule a solicitor that is registered with the Commission as a broker-dealer or otherwise subject to similar regulatory oversight.

The Associations recommend that the Proposed Solicitation Rule provide a blanket exclusion for any solicitor that is registered with the Commission as a broker-dealer, or otherwise subject to similar regulatory oversight. Registered broker-dealers are already subject to robust regulation (often in multiple jurisdictions) that includes an array of prescriptive and principles-based rules (*e.g.*, relating to every aspect of their sales practices). For example, new Regulation BI would directly regulate the solicitation practices of a broker-dealer that is also a solicitor.[106] In addition, FINRA imposes advertising, conflicts disclosures, and suitability rules on broker-dealers subject to its direct regulation.[107] In terms of regulatory surveillance and review, the

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[102] *See id.*, *supra* note 3, at 67579 (discussing the elimination of this requirement).

[103] *See* Proposed § 275.206(4)–3(a)(1)(iii).

[104] Commission Rule § 275.206(4)–3(a)(2)(iii)(C).

[105] *See* Proposed § 275.206(4)–3(a)(2).

[106] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33318 (July 12, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf.

[107] FINRA Rule 2210 (2019), available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2210 (regulating to advertisements and conflicts disclosures); FINRA Rule 2111 (2014), available at https://www.finra.org/rules-guidance/rulebooks/finra-rules/2111 (relating to suitability requirements).

Commission, FINRA, and each U.S. state has a multitude of regulatory tools available tool to review, supervise, and examine the activities of solicitors of advisory services who are registered broker-dealers. Moreover, the European Union and other G-20 countries impose equivalent requirements. As a result, while subjecting registered broker-dealers to the Current Solicitation Rule was perhaps appropriate when the Commission adopted that rule, applying the Proposed Solicitation Rule to broker-dealers registered with the Commission or otherwise subject to similar regulatory oversight would be redundant and unnecessary, given the broad scope of existing broker-dealer regulations that apply today.

3.5 The Proposed Solicitation Rule contains additional disclosure requirements that seem unnecessary or redundant.

The Proposed Solicitation Rule contains several additional requirements regarding solicitor disclosures,[108] including that a disclosure document must: (i) lay out "material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or the compensation arrangement";[109] and (ii) be presented to a prospective client separately from other materials.

The Associations note that the separate disclosure requirement for material conflicts related to compensation arrangements may be potentially redundant. Consistent with the Current Solicitation Rule, the Proposed Solicitation Rule requires the investment adviser or solicitor to disclose to the client the terms of any compensation arrangements.[110] By itself, we believe that this requirement is sufficient to convey the potential conflicts to solicited parties. However, the Proposed Solicitation Rule includes an additional provision that requires the investment adviser or solicitor to describe any potential material conflicts of interest resulting from the solicitor-investment adviser arrangement.[111] We believe that this additional requirement is unnecessary because we would generally expect the required disclosure for both provisions to be the same. As a result, the Associations consider that the disclosure requirement pertaining to material conflicts is of limited (if any) benefit, even as it unnecessarily lengthens solicitation disclosure documents and potentially leads to confusion.

In addition, the Associations do not believe that it is useful for the Commission to continue to mandate a separate disclosure document. While we understand that the Commission believes that doing so highlights this document, the addition of another standalone document paradoxically might overwhelm clients. Consider that separate materials mandated by Commission rules would now include the investment adviser's Form ADV, the solicitor's Form ADV (if applicable), the investment adviser's new Form CRS (if applicable), the solicitor's Form CRS (if applicable), and this disclosure document. In addition to the Commission-mandated documents, other regulators might mandate the provision of additional standalone documents (*e.g.*, tax documents), and the investment adviser would certainly need to furnish various account-opening documents. Given the volume of content that clients must receive, the

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[108] *See* Proposed §§ 275.206(4)–3(a)(1)(iii)(A)–(F).

[109] Proposed Rule Release, *supra* note 3, at 67574.

[110] *See* Proposed § 275.206(4)–3(a)(1)(iii)(D).

[111] *See* Proposed § 275.206(4)–3(a)(1)(iii)(E).

Associations request that in the final rule the Commission provide investment advisers and solicitors the flexibility to include the required disclosures prominently within other solicitation materials.

3.6 While an investment adviser's oversight of solicitors under the Proposed Solicitation Rule is beneficial overall, the proposed "reasonable belief" standard related to the written agreement between a solicitor and investment adviser is overly prescriptive.

The Proposed Solicitation Rule requires investment advisers to have a "reasonable basis for believing" that a solicitor has complied with the written agreement entered into between the solicitor and the investment adviser.[112] This "reasonable belief" standard would replace the "*bona fide* efforts" standard in the Current Solicitation Rule. The Proposed Solicitation Rule would also eliminate the requirement that investment advisers collect signed acknowledgements from clients affirming that the clients have received a solicitor disclosure document. We view these proposed changes as largely beneficial in that they help to streamline the documentation burdens related to the various relationships, and are consistent with a principles-based regulatory approach.

However, we are concerned by the Commission's suggestion that it believes investment advisers "generally" should "periodically mak[e] inquiries of a sample of investors" to meet the "reasonable belief" standard.[113] Requiring a specific process may work to undermine the flexibility otherwise suggested by the Commission's proposed changes, as many investment advisers would feel compelled to follow this suggested sampling method. Furthermore, we are especially concerned because this method may be more burdensome from a compliance standpoint than the Commission's guidance might imply. Sampling could well require investment advisers to organize, compile, and analyze periodic surveys. The Associations believe that the Commission should mitigate such a compliance burden whenever possible, and to this end, should clarify that this method is just one of many ways for investment advisers to comply with their oversight requirements. We further recommend that in the final rule the Commission recognize that solicitors already registered as broker-dealers or investment advisers are subject to policies and procedures designed to ensure compliance with regulatory requirements, and thus, reasonably can be presumed to act in compliance with the written agreements contemplated by the rule. In addition, the Associations ask the Commission to clarify that investment advisers can satisfy the "reasonable belief" requirement based on that presumption, barring any known contradictory information.

3.7 The expanded disqualification provisions in the Proposed Solicitation Rule are generally sensible, but could implicitly impose a significant and unnecessary duty on investment advisers to monitor their solicitors continuously.

The Associations appreciate that the Commission wishes to protect the investing public by barring investment advisers from liaising with ineligible solicitors. To this end, we generally support the expansion of the disqualification criteria under the Proposed Solicitation Rule,[114] in

[112] *Id.* at 67580.

[113] *Id.*

[114] *See* Proposed § 275.206(4)–3(a)(3).

part as the proposal appears broadly aligned with similar criteria under Commission Rule 506(d) of the Securities Act (the "**Bad Actor Rule**").[115]

However, with the expansion of the bases for disqualification, there also comes a greater likelihood of inadvertent compliance failures. The potential for compliance failures is aggravated by the fact that the prohibition on investment advisers compensating disqualified solicitors is based on the time of solicitation, rather than time of the adviser's engagement of the solicitation.[116] Because a solicitor may engage in frequent or multiple solicitations on behalf of an investment adviser, without further Commission guidance, some investment advisers may interpret this provision as requiring the continuous monitoring of solicitor status throughout the investment adviser-solicitor relationship to ensure that the solicitor has not become disqualified. Such a requirement would, in our view, unduly burden the investment adviser and exceed the "reasonable care" standard in the Proposed Solicitation Rule.[117] Therefore, the Associations recommend that the Commission include a safe harbor for investment advisers who review solicitors for evidence of disqualification on an annual basis.

Additionally, the Associations seriously question the Commission's broad treatment of disqualification by affiliation.[118] The Bad Actor Rule considers disqualification by affiliation more carefully than the Proposed Solicitation Rule, and requires that a firm monitor a known and circumscribed group of affiliates.[119] We do not believe that the Commission should disqualify a remote affiliate simply because it is in the chain of control with an ineligible solicitor. Such broad treatment of affiliate disqualification would especially impact large firms, potentially disqualifying large chains of affiliated entities with no connection to a disqualifying event. In addition, such a broad approach would prevent investment advisers from compensating such affiliated entities, and thus require investment advisers to monitor not only the disqualifying events of the entities soliciting on their behalf, but also the affiliates of their solicitors. Thus, this aspect of the Proposed Solicitation Rule is burdensome from both an investment adviser and solicitor perspective. Accordingly, the Associations recommend that the Commission revisit this element of the Proposed Solicitation Rule and incorporate into the final rule a more workable and sensibly circumscribed approach to disqualification by affiliation.

IV. PROPOSED ONE-YEAR IMPLEMENTATION PERIOD

The Associations respectfully request that the Commission extend the implementation period for the Proposed Advertising Rule and the Proposed Solicitation Rule from one year[120] to two years to provide affected parties a reasonable period of time to comply with the new requirements.

Regarding the Proposed Advertising Rule, unless the Commission implements both the various changes to the proposed definition of "advertisement" that we recommend and eliminates the

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[115] *See* 17 C.F.R. § 230.506(d).

[116] *See* Proposed § 275.206(4)–3(a)(3)(ii)(A).

[117] Proposed § 275.206(4)–3(a)(3).

[118] Proposed Rule Release, *supra* note 3, at 67588; Proposed § 275.206(4)–3(a)(3)(ii)(E).

[119] 17 C.F.R. §§ 230.506(d)(1), (d)(3).

[120] *See* Proposed Rule Release, *supra* note 3, at 67599.

proposed pre-use review and approval mandate, adapting current practices to this new environment would, among other matters, require investment advisers to hire and train new legal and compliance personnel. The existing staff of many affected investment advisers would not be of sufficient size to manage the significant increase in obligations, and with so many investment advisers needing to augment their staff simultaneously, a "supply and demand" issue would likely arise. In addition, both new and existing staff would need to undergo substantial training. Such an exercise, and especially increasing staff, requires accurately forecasting personnel needs, making necessary budgetary adjustments, and finally, successful recruitment and integration.

Within many investment advisers, the budgeting process is a long one that involves personnel from across various departments. Therefore, regulatory changes of the scope contemplated by the Proposed Rule Release would impose new budget requirements and affect the budgeting process of multiple—if not all—internal departments. Such a significant and widespread impact would necessitate substantial time to adapt. Depending on the scope of the final rule, investment advisers would also need to revise compliance related to: (i) current public communications, client and investor reporting frameworks, and recordkeeping processes; and (ii) the use of third-party service providers. In addition, investment advisers would need to build out new technological capabilities. Moreover, if the Commission does not significantly modify elements of the Proposed Advertising Rule relating to third-party interactions as we recommend above, investment advisers would need to coordinate and potentially modify arrangements with a wide array of third parties throughout the implementation process. Accomplishing all of the foregoing tasks within a one-year period would be extremely difficult for nearly all investment advisers, and would necessitate investment advisers finding and allocating significant financial resources to the transition, which most firms would expect to budget over a multi-year period.

Regarding the Proposed Solicitation Rule, investment advisers and solicitors would need to: (i) revise existing contracts or enter into new contracts where existing relationship become newly subject to these rules; (ii) overhaul compliance policies and procedures; and (iii) design and implement various new oversight and diligence terms. As with the Proposed Advertising Rule, this process would require the dedication of significant amounts of staff time, resources, and training, as well as significant interaction with third parties including legal counsel. To the extent that, notwithstanding our objections, the Commission proceeds with subjecting non-cash compensation to the rule, the scope and variety of potential changes to third-party arrangements would be significant and any such arrangement would need to be reviewed, adapted, and ultimately brought into compliance with the final rule.

In addition to the foregoing, the Proposed Advertising Rule and the Proposed Solicitation Rule pose numerous and difficult interpretive questions and uncertainties as to their application that investment advisers, solicitors, broker-dealers and others would need time to assess prior to proceeding with the many other steps necessary to prepare for compliance. To address such issues responsibly and on an industry-wide basis would be a substantial undertaking. Thus, the Associations believe that a two-year implementation period is required for this transition to occur smoothly, and to prevent the need for Commission staff to provide an abundance of no-action relief.

V. THE COMMISSION'S ECONOMIC ANALYSIS

5.1 The economic analysis found in the Proposed Rule Release does not accurately reflect the costs of the Proposed Advertising Rule and Proposed Solicitation Rule.

The Associations respectfully conclude that the economic analysis in the Proposed Rule Release does not accurately reflect the true costs implied by the proposals.[121] In particular, as discussed throughout this letter, the Proposed Advertising Rule and Proposed Solicitation Rule, if adopted, would impose substantial costs on investment advisers, broker-dealers, and solicitors. The Commission has not considered the full scope and amount of these costs in its economic analysis.

The Associations believe that some of the proposed changes are positive and could foster more natural and robust communication between investment advisers and their clients and investors. Because costs associated with change are inevitable, we certainly do not intend to imply that cost concerns alone warrant not proceeding with important and necessary rulemaking (although, to be clear, the Associations see many significant issues with both the Proposed Advertising Rule and the Proposed Solicitation Rule). However, we do believe that the economic analysis needs to bear a reasonable relationship to actual anticipated costs if it is to inform a thoughtful rulemaking process. It is with this view in mind that we offer the following observations.

With respect to investment advisers, we believe that the costs of the Proposed Advertising Rule and Proposed Solicitation Rule would include:

- Substantial implementation costs, which would disproportionately impact smaller investment advisers;
- Substantial ongoing costs, including: (i) necessary changes to policies and procedures; (ii) modification of systems; (iii) training of legal and compliance personnel; (iv) training of personnel (other than legal and compliance personnel); and (v) for many investment advisers, hiring of new personnel and/or retention of external consultants, attorneys and other advisors to advise and assist with implementation and ongoing compliance; and
- Substantial management resource drain as senior management grapples with the Proposed Advertising Rule and Proposed Solicitation Rule.

In lieu of a full and reasonable consideration of these costs, the Associations believe that the economic analysis, as proposed, significantly underestimates the time and costs that compliance with the Proposed Advertising Rule and Proposed Solicitation Rule would require. For example, in respect of the Proposed Advertising Rule, the economic analysis:

- States that there would be no initial implementation costs relating to the use of testimonials and/or endorsements,[122] and thus, estimates that an investment adviser who includes

[121] *See id.* at 67600.

[122] *Id.*

testimonials or endorsements in its advertisements would incur an internal burden of one hour to prepare the required disclosure, and an annual cost of $337.00;[123]

- Estimates that an investment adviser's increased costs of finalizing the required third-party rating disclosure would be 1.5 hours or $505.50,[124] and that the annual costs of updating such disclosures would be "0.375 burden hours"—approximately 23 minutes;[125]

- Estimates that an investment adviser that elects to present gross performance for three different portfolios would incur additional initial implementation costs of approximately $4,692,[126] and an annual burden to update performance disclosure of 10.25 hours;[127]

- Estimates an initial cost of $8,425 for each investment adviser to comply with this proposed requirement to present all related portfolios in connection with any related performance;[128]

- With respect to "hypothetical performance", estimates an initial burden of five hours to adopt policies and procedures,[129] and an initial burden of 16 hours to prepare the information necessary to understand the criteria used and assumptions made as well as risks and limitations in using "hypothetical performance";[130]

- With respect to presentation of net performance, estimates that an investment adviser that elects to present gross performance in a "retail advertisement" would incur an initial burden of 10 hours in preparing net performance for each portfolio per year.[131] Also, estimates that the average investment adviser would present performance for three portfolios over the course of a year, at a total initial burden of 30 hours;[132]

- With respect to review of advertisements, estimates 10 hours for light advertisers and 50 hours for heavy advertisers of external legal services per year to review advertisements;[133] and

- With respect to the Form ADV changes, "[does] not expect that the proposed amendments would increase or decrease the currently approved total burden estimate of 3.60 [hours] per exempt reporting adviser completing Form ADV".[134]

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[123] *Id.* at 67622.

[124] *Id.* at 67623.

[125] *Id.*

[126] *Id.* at 67624.

[127] *Id.*

[128] *Id.*

[129] *Id.* at 67625.

[130] *Id.*

[131] *Id.* at 67626.

[132] *Id.*

[133] *Id.* at 67627.

We do not believe that any of these estimates approximate the real costs involved. Rather, these estimates, in our view, reflect a broad misunderstanding of the time and effort taken by responsible participants in the financial industry to review and revise policies, procedures, and associated materials when new rules are adopted. In addition, the foregoing are mere examples, and the economic analysis contains many other estimates that also significantly underestimate time and costs.

To illustrate the inaccuracy of the current analysis, we select three of the cost estimations above for further consideration:

- *Third-party rankings.* As noted, the Commission's estimation of costs associated with the proposed third-party ranking requirements total 1.5 hours for initial implementation by an investment adviser and focus solely on the costs of new disclosure. Such an estimate bears no relationship to the reality that drafting thoughtful, tailored disclosures from scratch both takes a significant amount of time up front and requires review, consultation, and redrafting with the benefit of input from others. It also ignores the fact that many investment advisers would ask the third-party ranking organization to review and comment, which predictably adds both coordination time and additional substantive consideration and redrafting. It also assumes that neither outside counsel nor consultants are involved, and it assumes that only a single third-party ranking is involved.

  The list goes on. The estimate is then wholly faulty in that it appears to ignore all obligations associated with the suggestion in the Proposed Rule Release (to which the Associations have objected) that an investment adviser would conduct diligence on each third-party ranking organization, a task that would require significantly higher than 1.5 hours by itself.

- *Hypothetical performance.* As noted, the Commission's estimation of costs associated with the proposed "hypothetical performance" requirements assumes five hours to adopt initial policies and procedures and 16 hours to prepare the explanatory and risk information. A basic understanding of the various processes that attach to any new policies and procedures at an organization of any scale or complexity would immediately rebut the idea that this exercise would take only five hours. Consider that a committee or working group of five members would consume that five-hour budget by meeting on this topic *just once*. Consider further the reality that such committee or working group is likely to meet multiple times, would be reporting up to senior management, would be interacting with outside counsel and consultants, and would be exchanging multiple drafts of the procedures and testing them with constituencies outside the group, potentially including representatives of affiliates and third parties such as fund administrators, record-keepers, solicitors and marketing agents, and others. The resulting workload is clearly far in excess of five hours.

  Much the same issues attach to the suggestion that preparation of the related explanatory and risk information can be done in 16 hours. Assuming the presentation issues with certain types of "hypothetical performance" are as complex as suggested by the Commission's proposed rulemaking framework, then we should further assume that a responsible organization tackling those issues would draw on input from its investment teams, as well as

[134] *Id.* at 67636.

technology, operations, marketing or investor relations, and legal and compliance personnel. Again, the work associated with a phased and thoughtful approach that draws on those various constituencies—and periodically tests the resulting disclosures with an array of third parties—simply cannot be done in the time allotted. The time needed would increase further for organizations that face the additional practical and operational hurdles associated with protecting intellectual property that we discuss above in Section 2.6.3. Extensive consultation with senior management, intellectual property attorneys, and others would be needed to identity and to the extent practicable mitigate the franchise risks involved.

- *Form ADV.* The Commission's proposition that responding to the proposed supplemental questions to Form ADV would neither increase nor decrease the time required to complete the form cannot withstand scrutiny. The addition of new questions to a regulatory form by definition must add to the time and burden of completing the form, such that the presumption of no impact is highly questionable. To the extent that the Commission believes its questions would have value to it and to the public, it must presume that investment advisers would address each question with rigor and care, and accordingly, devote time to them. The time needed to complete these questions is especially acute given the range of interpretive questions that we have identified above for example, as to who might be deemed a solicitor and whether cash or non-cash compensation would be considered in connection with third-party rankings. Questions about solicitors and third-party rankings, therefore, have the potential to be highly complex in practice. However, none of these costs appear to have been considered.

Thus, as partially suggested by these examples, the Commission's current economic analysis fails to recognize whole *categories* of costs that would arise in connection with the Proposed Advertising Rule and Proposed Solicitation Rule. For example, the economic analysis with few exceptions ignores:

- The time that an investment adviser would incur to draft policies and procedures that are reasonably designed to achieve compliance with the Proposed Advertising Rule and Proposed Solicitation Rule;

- The time and costs associated with the difficult interpretive challenges that would follow from a number of the Proposed Advertising Rule and Proposed Solicitation Rule elements;

- The costs of outside counsel and consultants whom many investment advisers would use to assist with initial and ongoing compliance;

- The opportunity and other costs associated with the resource diversion of senior management, legal staff, and compliance staff in order to achieve compliance with the Proposed Advertising Rule and Proposed Solicitation Rule;

- The costs of training legal personnel, compliance personnel, investor relations teams, and a broad array of other adviser personnel on the principles, policies and procedures relating to the Proposed Advertising Rule and Proposed Solicitation Rule; and

- The downstream cost burdens that would accrue to: (i) the distributors of an investment adviser's products—in particular broker-dealers—who must also review and revise policies, procedures, and systems in order to seek to ensure compliance with the Proposed Advertising Rule and Proposed Solicitation Rule, and who must also take time to train personnel on the Proposed Advertising Rule and Proposed Solicitation Rule; and (ii) solicitors, who must completely overhaul their policies and procedures in relation to the solicitation of advisory services and products.

It is also important to recognize, as part of the economic analysis, that the increased costs created by the Proposed Advertising Rule and Proposed Solicitation Rule are fixed costs that are difficult to reduce absent significantly reduced activity by any particular investment adviser. The addition of non-discretionary, fixed costs to every investment adviser should not be undertaken lightly. In particular, to be complete, the economic analysis must explain why these non-discretionary, fixed increases should be mandated over other priorities, such as improving cybersecurity, hiring advisory personnel, or training personnel.

Therefore, the Associations strongly believe that the economic analysis is incomplete and inaccurate. Moreover, to meet the applicable statutory requirement,[135] and more generally, to serve as an appropriate basis for informed consideration, we believe that the Commission must prepare the economic analysis, *de novo*, with the assistance of, and input from, a broad array of the would-be-affected investment advisers, broker-dealers, and solicitors as to actual time and cost burden. Such further analysis is particularly important in respect of the various elements of the Proposed Advertising Rule and Proposed Solicitation Rule that we have identified as highly prescriptive, impractical, unworkable, and/or subject to unduly difficult interpretation. We are, of course, ready to assist the Commission further in this regard.

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[135] Paperwork Reduction Act of 1995, 44 U.S.C. § 3501. *See also* Commission Memorandum regarding Current Guidance on Economic Analysis in SEC Rulemakings (Mar. 16, 2012), available at https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.

The Associations appreciate the opportunity to provide comments to the Commission on the Proposed Rule Release. We welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact Carlotta D. King of MFA at 202-730-2600 or Jiří Król of AIMA at 202-919-4940 with any questions that you, your respective staffs, or the Commission staff might have regarding this letter.

Respectfully submitted,

/s/ Carlotta D. King

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cc: The Hon. Jay Clayton, Chairman
The Hon. Robert J. Jackson Jr., Commissioner
The Hon. Hester M. Peirce, Commissioner
The Hon. Elad L. Roisman, Commissioner
The Hon. Allison Herren Lee, Commissioner