February 10, 2020

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

Attention: Vanessa A. Countryman, Secretary **Submitted via Email**

Re: File Number S7-21-19 – Comments are in PDF format

Ladies and Gentlemen of the Commission,

Thank you for allowing me to comment on SEC Proposed Rule 206(4)-1. I have separately commented on SEC Proposed Rule 206(4)-3. Page references used throughout are to the PDF version of SEC Release No. IA-5407 (November 4, 2019), available on the SEC website under "Regulations/Proposed Rule."

I am the president of a registered investment advisory (RIA) firm that I founded in 1981, with assets under management (AUM) of approximately $1.6 billion (as of 12/31/2019) and approximately 90 employees. We are an asset management company offering primarily separately managed accounts (SMAs) on a wide range of custodial, variable annuity, brokerage, 401(k), and 403(b) platforms.

Our SMAs are distributed consistent with written solicitor or co-advisory agreements with over 500 different independent broker-dealer (BD) and RIA firms. These firms employ tens of thousands of financial representatives that may offer our SMA services to retail investors. Over 1,000 of these representatives have clients with our firm. The firm manages about 19,000 subaccounts for these clients.

Comments on the proposed rule 206(4)-1:

I have reviewed the comments filed to date and agree with the concerns expressed in them.

In addition, I have concerns about the following:

1. Section (a)(3) prohibits an advertisement that "includes an untrue or misleading implication about, or reasonably be likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the investment advisor."

The section's use of the word "implication" without modification seems overly broad. An implication's existence is judged by what one believes to be in the mind of both the presenter and the audience. These can differ substantially. The same reasoning applies to finding the existence of an "inference."

Yet section (a)(3) treats the terms differently. The existence of an "inference" is modified by the phrase "reasonably be likely to cause." The use of "implication" is not so modified.

Since both an inference and an implication rely upon what is in the minds of the presenter and the audience of an advertisement, it would seem better to have the same standard. This avoids the presumably unintended consequence of someone inferring that the standard is somehow different for an "inference" than it is for an "implication."

I would suggest alternative language for section (a)(3) as follows: "Includes language that would reasonably be likely to cause an untrue or misleading implication or inference to be drawn concerning a material fact relating to the investment advisor."

2. Section (c)(1)(v) prohibits any advertisement from including "any hypothetical performance unless the investment adviser:

> "(A) Adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the advertisement is disseminated;
>
> "(B) Provides sufficient information to enable such person to understand the criteria used and assumptions made in calculating such hypothetical performance; and
>
> "(C) Provides (or, if such person is a non-retail person, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such hypothetical performance in making investment decisions."

"Hypothetical performance" is broadly defined. By virtue of the definition supplied by the proposed rule at section (e)(5), the term would seem to include, among other items, research backtests; market, sector, and strategy indexes; and model account performance. While it may be that the commission wishes to include one-on-one communication within the proposed rule, I don't believe it is the commission's intention to restrict its use to only one-on-one advertisement.

Yet the use of the singular term "person" in section (c)(1)(v)(A) associated with the phrase "relevant to the financial situation and investment objectives of" suggests the requirement of knowledge of the specific individual circumstances of each person to whom the advertisement is disseminated. Similarly, the reference in sections (c)(1)(v)(B) and (C) to "such person" as it relates to understanding "the criteria used and assumptions made" seems to support the same conclusion.

Given the need to widely disseminate (to clients and prospective clients) research results whenever a new product is contemplated, a change is made in an existing product, or a comparison is necessary between actual performance of a strategy and what was anticipated or was probable considering previous research results (e.g., the creation of benchmarks based on Monte Carlo probabilities exhibited in hypothetical research for comparison with actual results thereafter), I do not believe this is the commission's intent. This belief is buttressed by the language used to describe the rules with respect to hypothetical performance in the "Smaller Adviser Feedback Flier" promulgated by the commission staff.

On page 5 of the flier, the first bullet point of the summary description of the rule refers to "persons" instead of the singular "person" found in the proposed rule. In addition, the second and third bullet points of the flier on page 5 refer broadly to "the audience" rather than "such person," as used in the proposed rule. I believe that the language used in the flier description is more practical for use in a rule concerning advertising.

Additionally, to facilitate the understanding of the standard's purpose, I would like to see the word "generally" added to subsection (A) before the word "relevant" to make clear that the rule is not referring to each individual's specific financial situation.

Finally, in subsections (B) and (C), I would suggest the addition of the word "reasonably" before the word "enable" in both subsections. Similar to my discussion of section (a)(3) in (1) above, the question of a person's "understanding" can differ widely from person to person. I believe adding a reasonableness standard would help avoid overly harsh application of the standard and aid in its application in real-world situations in the future.

The language considerations laid out above aside, I believe that the "relevancy" requirement in the proposed rule will be extremely difficult to practically administer. It will be dependent on knowing in many cases the exact person to whom the use of hypothetical performance is being delivered. It is subject to hindsight bias in that investors would always know they didn't receive what they considered relevant after the fact, even when the fact was an unforeseeable event.

In the alternative, the way securities practitioners deal with this in prospectuses and other disclosure documents is to list all possible risks and circumstances that might exist in the foreseeable future for the type of investment being made. This has proven to be a practical solution in all manner of securities and all levels of speculation. But here it would seem to run counter to the relevancy to the recipient standard being proposed. <u>No other investment requires disclosures to be subject to such a standard.</u>

The likely effect of the rule will be to greatly diminish the use of hypothetical performance. Yet in its discussion of the new rule, the commission acknowledges the cogent reasons why providing such information is important. Innovation of strategies and the introduction of new advisers with new methodologies would be subject to a substantial chilling effect.

The proposed rule introduces this new concept of relevancy to the recipient despite the fact that it provides no evidence that the current use of hypothetical performance has had a negative effect on the financial-services industry. The industry has successfully existed for almost 35 years under the standards set forth in Clover Capital Management (Clover Capital Mgmt., Inc., SEC Staff No-Action Letter of Oct. 28, 1986) and its progeny without any major incidences. Similarly, the rules promulgated under the Commodity Futures Trading Commission concerning hypothetical performance do not include a relevancy requirement and have been successfully employed in regulating the use of the same (CFTC Rule 4.41(b)(1)(i)).

At the same time, neither of these standards has required the provision of sufficient information to enable a person to understand the criteria used. On page 172 of its discussion, the commission interchangeably uses the word "methodology" for "criteria." This appears to require a disclosure of a strategy's actual methodology.

This is the most onerous part of the new standard. The discussion provides no practical alternative means to satisfy this requirement. The commission must know that the financial-services industry is extremely competitive. The strategies used are one of the ways firms differentiate themselves. The methodologies and criteria used on those strategies are as a result normally closely guarded secrets. These secrets are proprietary. The need to keep them that way has been highlighted of late by the need to develop non-transparent ETFs to enable a wider number of advisers to make their strategies available in such vehicles.

Finally, the commission in its discussion of the proposed rule again on page 172 opines the following:

> We believe that 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 or investment objectives.

In contrast, I believe that if an adviser has hypothetical performance data and does not disclose it, it may be an omission of a material fact. It is certainly relevant to any investor's decision, i.e., it is information that, if it exists, a reasonable investor would want to have before investing.

I have yet to find an investor who would not want to know the maximum loss that was achieved under a proposed strategy over past years, especially volatile years. Conversely, who would not want to know the return achieved by the application of a proposed strategy during particularly bad years in the market? If actual performance is not available to provide answers, but hypothetical performance is, they would want to know it. And they would not need sophisticated analytical abilities or tools to understand it. Such information is relevant to all investors.

A better way to handle hypothetical investment performance would be to add the Clover rules to the actual advertisement/performance rules and, in addition, to require a predefined disclosure of risks as the CFTC provided. Alternatively, or additionally, one could require such rules in lieu of the relevancy to recipient standard whenever a client is represented by a solicitor, or better still, a person registered under the act other than the adviser. This would ensure that the recipient had access to a non-retail person as a resource when considering the hypothetical performance information.

Thank you for your consideration of these comments.

Sincerely,

Jerry C. Wagner, J.D.

President

Flexible Plan Investments, Ltd.