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)-3. I have separately commented on SEC Proposed Rule 206(4)-1. 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)-3:

1. Proposed rule 206(4)-3(a) deals with an adviser's compensation of a solicitor for solicitation activity. Not only is "solicitation activity" a prerequisite for application of the rule, but it also triggers the timing of when a separate disclosure must be delivered to a client under proposed rule 206(4)-3(1)(iii). The phrase is not defined separately but can presumably be derived from the definition of a "solicitor" in section 206(4)-3(c)(4) as when a person, directly or indirectly, solicits a client for, or refers any client to, an investment adviser.

While the timing of such actions (the referral and the soliciting) is known to both the client and the solicitor, it is not known to the adviser or to a financial representative's broker-dealer. They are not present at the time of either action. Therefore, making this the time of delivery creates problems for both enforcement and compliance. It is not surprising that the commission discussion cites at footnote 391 on page 222 the many requests for information on what satisfies the disclosure delivery or that the commission presented four pages of questions that delivery raised in its discussion of the proposed rule (pp. 223–226).

On page 223, the commission asks, "When should the solicitor disclosure be delivered to investors?"

Rather than making the delivery at the time of the “solicitation activity,” or, in the case of a mass communication, having to make it as soon as reasonably practicable thereafter, delivery should simply be required before the recipient of the solicitation or referral becomes a client of the adviser. Alternatively, this could also be made consistent with the Adviser ADV delivery requirement imposed by SEC Rule 204-3(b)(1), including the exception relating to the five-day rescission right.

The advantage of this timing is that the adviser and a financial representative’s broker-dealer would be immediately aware of the solicitation or referral. It would be administratively easier to impose supervision and review of the solicitor’s actions at that time.

Where the adviser is, in effect, wholesaling its services through the efforts of broker-dealer representatives or RIA employees, as we do, the adviser, BD, and RIA firms are likely not aware of who the solicitor is or what the terms of the compensation are at the time a client is solicited or referred. For example, in our case, we do not set the solicitor’s fee but merely impose a maximum. The actual solicitor fee for each client is chosen by the adviser when the investment management agreement is completed using our automated agreement process. After the solicitor completes the form and selects a fee, the investment management agreement and the separate written disclosure with the selected inputs are supplied for delivery to the client.

Providing for the delivery of the separate disclosure at or before execution of the contract or at the time ADV delivery is allowed for satisfies the commission’s original “belief that separate solicitor disclosure was necessary to ensure that the investor’s attention would be directed to the fact that the adviser pays the solicitor a cash referral fee and the incentives it may create” (p. 213).

It would also be consistent with the commission’s presently expressed goal of delivering “a separate, targeted disclosure” that “would draw the investor’s attention to the solicitor’s bias in recommending an adviser directly or indirectly compensating it for the referral,”(p. 213) and this could all still be accomplished before the investor had contracted with the adviser.

Provision of the delivery at a point in time at which the adviser becomes aware of the solicitor and client allows the adviser to more practically “have a reasonable basis for believing that the solicitor has complied with the written agreement required …” (proposed rule 206(4)-3(a)(2)).

As such, it is also consistent with the new rule’s provision that either the adviser or the solicitor can deliver the disclosure. Since it is not practical for an adviser to deliver at the time of a “solicitation activity” that is likely happening at a time, place, and among parties and terms unknown to the adviser, the BD, or RIA firm, the suggested alternative time is the only one where having the choice of either the solicitor or adviser is even feasible.

The “Smaller Adviser Feedback Flier” promulgated by the commission staff (p. 14) summarizes proposed rule 206(4)-3(a)(2) as follows: “The advisor must oversee the solicitor’s solicitation activities.” I do not believe that language represents what the commission is saying in the cited section of the proposed rule and would hope that staff would not enforce it that way.

As the commission points out (pp. 229–230), it is difficult for an adviser to be able to oversee the solicitors' solicitation activities. When the solicitors are not the adviser's employees, the adviser cannot direct them, censor them, or otherwise control them.

The solicitation activities occur at a time, place, and among parties and terms unknown to us. The solicitor referring the first piece of business to us may have never met with a representative of our firm. Likely, we have not met with the client. The financial representative of the broker-dealer signing the solicitor agreement perhaps only knows that we are listed in the BD's materials as having an agreement with them.

Also, the commission points out the following: "We believe this requirement could be difficult or impractical to implement in a number of contexts, however, such as when advisers enter into solicitation agreements with many different solicitors or the solicitor is a much larger institution than the adviser." This is certainly the case with my firm, which receives most of its business from BDs that are much greater in size than we are, and with whom we have little leverage.

Finally, the solicitors in our case are members of firms already registered with the commission. As BDs and RIAs, they already have to meet conflict-of-interest disclosure requirements. One wonders, and the commission asks, why solicitors of such registered entities should be included under the solicitation rule (similar to the rules for RICs and BDCs). It seems duplicative and inefficient with little gain for the investor in such cases. The same can be said for all employees of the adviser, without the need for the requirements set forth in 206(4)-3(b)(2)(i) and (ii).

2. The commission asks if "compensation" should be defined for purposes of the proposed rule. I'm not sure that a definition is as necessary as guidelines are, but more is needed than what is contained in the rules.

This is especially true regarding the requirement in proposed rule section 206 (4)-3 (a)(1)(iii)(D). It requires disclosure of "the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor."

It is not at all clear whether reimbursing the BD solicitor or its representatives for third-party expenses in the solicitation process (say, for a client seminar or client-appreciation dinner) would be compensation, as it would not be such for tax purpose. Similarly, the performance of bona fide services provided to adviser's solicitors and non-solicitors alike should not be compensation as long as it is not tied to a sales incentive.

What about reimbursing the third-party costs for due diligence visits by solicitors or prospective solicitors? Or for the same costs to attend advisory meetings, obtain Series 65 licensing, or educational sessions on the adviser's tools, forms, and procedures?

Sponsoring at trade shows of BD solicitors requires the payment of fees that are said to offset expenses of the show. Similarly, some solicitor BDs require the payment of a platform or due diligence fees to offset expenses. Are these items compensation? Do they require specific details of the amounts paid for each item in the separate disclosure?

Or is the description of the types of compensation in the ADV and SWD, as is presently done, sufficient? I would argue that doing so satisfies the commission's purpose for the separate disclosure set forth above. It is also more practical, as detailing the specific payments made to both the solicitor and the representatives of the solicitor would be nearly impossible to prepare in a timely manner.

Finally, as to the matter of non-cash compensation, we would prefer that the commission not specify a dollar amount as de minimis. Instead, we believe that the specification of the types of compensation that would be deemed de minimis would be a better route. General inflation and, specifically, the rising costs of meals, entertainment, and even wearables such as t-shirts are quickly rendered obsolete.

Thus, we would favor a more principles-based de minimis exception rather than one based on a dollar value. It could exempt promotional items of nominal value and commemorative items, the cost of an occasional meal, golf rounds, or tickets to a sporting event or the theater, or comparable entertainment that is neither so frequent nor so extensive as to raise any question of propriety. To aid in the enforcement of this and other exemptions from registration detailed above, I would favor the additional requirement of adviser record keeping to track such expenses.

Thank you for your consideration of these comments.

Sincerely,

Jerry C. Wagner, J.D.

President

Flexible Plan Investments, Ltd.