MARKETCOUNSEL®

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VIA INTERNET UPLOAD

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

Re: File No. S7-22-19: Investment Adviser Advertisements; Compensation for Solicitations

Dear Ms. Countryman:

We commend and support the U.S. Securities and Exchange Commission's (the "Commission") effort to reform how investment advisers advertise and solicit prospective clients.[1] These changes effectually respond to industry developments with a principles-based approach to regulation. MarketCounsel Consulting ("MarketCounsel") shares the Commission's goals of protecting investors, ensuring that regulation fits today's business practices, and adding flexibility for the future, which these changes can achieve.

For perspective, MarketCounsel is a business and regulatory compliance consulting firm to some of the country's preeminent independent investment advisers. In addition, our affiliated law firm, the Hamburger Law Firm, renders legal counsel to entrepreneurial investment advisers, broker-dealers, private funds, family offices, and registered securities personnel. From its roots in 2000, MarketCounsel has been steadfast in its mission to deliver elegant solutions to the most substantial challenges faced by entrepreneurs in this fast-growing and highly-regulated industry.

The changes proposed by the Commission affect two long-standing rules promulgated under the Investment Advisers Act of 1940 (the "Advisers Act"). The first set of changes address advertisements by investment advisers which are governed by Rule 206(4)-1 under the Advisers Act (the "Advertisement Rule" and the proposed amendments referred to as the "Advertisement Amendments"). The second set of changes pertains to how investment advisers pay others to solicit business on their behalf which are governed by Rule 206 (4)-3 under the Advisers Act (the "Solicitation Rule" and the proposed amendments referred to as the "Solicitation Amendments"). While we support these changes, we do have recommendations that we believe would be beneficial to investment advisers without any detriment to consumers.

[1] Investment Adviser Advertisements; Compensation for Solicitations, SEC Rel. No. 5407, 84 Fed. Reg. 67518 (Dec 10, 2019) www.govinfo.gov/content/pkg/FR-2019-12-10/pdf/2019-24651.pdf ("The Amendments").

THE ADVERTISEMENT AMENDMENTS

Background on Advertisements

Investment advisers use advertisements to attract new clients, inform consumers about services offered, and persuade them to purchase those services.[2] In the competitive landscape of the financial services industry, investment advisers need to create advertisements that are interesting and attract consumers. This dynamic creates a natural temptation to advertise in a manner that would be deemed misleading. Therefore, the Advertisement Rule must strike a balance between the investment adviser's efforts to grow their business while protecting consumers from misleading or unsubstantiated claims.

The Advertisement Rule and its interpretations have long frustrated investment advisers. As the discussion in the rule amendment release (the "Discussion") makes clear, much has changed in the almost six decades since the Commission adopted the current Advertisement Rule.[3] First, the internet has made social media an integral part of business communications and technology has improved the quality and quantity of the information available to consumers. Second, technology has shaped how consumers make decisions. Consumers now use the internet to obtain information about new products and services, which often includes reading through other consumer's experiences with, and ratings of, those products and services. Third, the nature of the types of investment adviser services offered has become more personalized as wealth managers offer options from estate planning to bill paying. Fourth, the types of clients has expanded to include a range from Main Street retail investors, to sophisticated institutional investors, which makes a one-size-fits all approach less practical. Finally, broker-dealers have continued to make their services indistinguishable from investment advisers while enjoying less restrictions on the use of testimonials.

General Support for the Advertisement Amendments

On the whole, we believe that the Advertisement Amendments strike a balance between the risk that advertisements could be misleading and the desire to permit more informative and useful advertisements to help consumers. The Advertisement Amendments remove certain advertising restrictions and add a principles-based approach in order to allow investment advisers more flexibility to grow their business. For example, the Advertisement Amendments permit testimonials and endorsements, subject to specified disclosures, including whether the person giving the testimonial or endorsement is a client and whether compensation has been provided by or on behalf of the adviser.[4] Similarly, the Advertisement Amendments permit third-party ratings, subject to specified disclosures and certain criteria pertaining to the preparation of the rating.[5]

All of these changes are more permissive than restrictive. We support these changes and applaud the Commission's work in this area. However, we believe that the Advertisement Amendment's pre-use review and approval requirement is contrary to the principles-based approach throughout the rest of the Advertisement Amendments (and the Advisers Act) and is unnecessary. A principles-based standard would allow investment advisers to implement the policies and procedures appropriate to that firm's risks. The review and approval requirement creates more burdens on investment advisers, deviates from a principles-based approach, and, especially in the case of social media posts, does not align with usage or consumers' preferences.

Recommendations Regarding the Review and Approval Requirement

The Advertisement Amendments would require an investment adviser to have an advertisement reviewed and approved before disseminating. The Discussion states that the review and approval requirement is needed to ensure that investment advisers have an advertisement review process in place and that this

[2] The Amendments at 84 Fed. Reg. 67519
[3] The Amendments at 84 Fed. Reg. 67520
[4] See Proposed Rule 17 C.F.R. 275.206(4)-1(b)(1)
[5] See Proposed Rule 17 C.F.R. 275.206(4)-1(b)(2)

requirement will also allow for the Commission's examination staff to better review compliance with the rule.[6] While we understand the Commission's goals, we respectfully disagree with this proposed requirement.

First, we do not believe that investment advisers should be required to review and approve advertisements. The Advertisement Rule already requires an investment adviser to, "keep copies of each notice, circular advertisement, newspaper article, investment letter, bulletin, or other communication that is circulated to ten or more persons." In the discussion of the rule release to Advisers Act Rule 206(4)-7, the Commission said that it expects that an investment adviser's policies and procedures should address "the accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements."[7] Therefore, investment advisers should already have a process in place to ensure that advertisements are accurate and proper under the Advisers Act, and that procedure should relate to the size and complexity of the firm.

The Advisers Act is not meant to be a rules-based law; it is considered to be principles-based. While there are certainly rules that investment advisers must follow, they often allow for flexibility, which has allowed smaller investment advisers to flourish where small broker-dealers have struggled. The Commission has not provided any reason to believe that investment advisers have failed in meeting their duties under the current advertisement requirements. We submit that there are times when an investment adviser should be allowed to determine that review and approval are unnecessary. For example, if the investment adviser has an individual experienced with the Advertisement Rule who wishes to use social media regularly, we believe it would be adequate to periodically review a sampling of that person's posts. If the investment adviser finds problems, then they should review further and possibly revise policies and procedures. We believe this better fits within the principles-based scheme of the Advisers Act.

Alternatively, if the Commission does choose to implement a review and approval requirement, we respectfully submit that investment advisers be allowed to do so prior to or *after* dissemination. Another reason the Discussion gives for the review and approval requirement is the belief that the requirement will reduce the likelihood of rule violations.[8] While the belief is not supported by data, that intention can be just as easily accomplished with a post-publication review. The Advertisement Amendments acknowledge that advertising has changed over the years. While it may make sense to get pre-approval of a website redesign or a new brochure, pre-approval is impractical for other types of advertisements, such as social media and emails in response to rapidly-developing events such as volatile markets, for example. Post-publication review would allow investment advisers to respond quickly and disseminate information to clients and prospects. That is beneficial to the investment adviser, but also serves the needs of clients and prospects. In fact, we believe that post-publication review would result in better Advertisement Rule compliance. Firm personnel would not feel the need to pressure (or avoid) the firm's compliance review to get their messaging out rapidly and the firm's compliance staff would have time to do a comprehensive review.

Finally, the Advertisement Amendments recognize that, in some cases, the review and approval requirement may be a significant burden on investment advisers.[9] Consequently, the Advertisement Amendments offer two exceptions to the review and approval requirement: (i) communications disseminated only to a single person or household or to a single investor in a pooled investment vehicle; or (ii) live oral communications broadcast on radio, television, the internet, or any other similar medium.[10] The reason given for these exemptions is to avoid placing a significant burden on the investment adviser's individual communications with clients or potential clients. The Commission acknowledges that the review and approval could have

[6] The Amendments at 84 Fed. Reg. 67568
[7] Final Rule: Compliance Programs of Investment Companies and Investment Advisers, U.S. Securities and Exchange Commission, 17 Dec. 2003, www.sec.gov/rules/final/ia-2204.htm
[8] The Amendments at 84 Fed. Reg. 67568
[9] The Amendments at 84 Fed. Reg. 67568
[10] See Proposed Rule 17 C.F.R. 275.206(4)-1(d)

an adverse effect on the investment adviser's business due to the delay in communicating with clients. For these same reasons stated by the Commission, we submit that social media posts should also be exempted. Social media is often conversational and is only worthwhile if it is timely. Canned, stale social media content is generally deemed useless. Therefore, the Commission should add an exception to the review and approval requirement for social media posts for the same reasons that supports its two current exceptions.

Addressing Additional Review and Approval Issues

The Discussion poses further questions for comment regarding the review and approval requirement.[11] We respectfully submit the following responses to certain of those questions:

- The first section asks about who can do the reviews and approvals. We do not believe that the Commission should include any requirements regarding who conducts the reviews and approvals. That includes whether the person should be in "legal or compliance," or "senior management." In addition, third parties should be allowed to conduct the review. Nowhere else in the Advisers Act does it contain any other personnel limitations and we see no reason for the Advertisement Rule to be inconsistent.
- The next section asks about the division of reviewer and approver authority from the creator. As stated above, we do not believe that advisers should be required to review and approve the advertisement. If, however, the Commission proceeds with the requirement, then there certainly needs to be an exception which would allow smaller advisers to approve their own materials similar to the exception found in the code of ethics Rule 204A-1(d) that allows small advisers with only one access person to have that person approve his or her own personal security investments.
- Bullet point four and six ask for comments about other types of exceptions from review and approval, including whether the process should differ based on the audience. As stated above, we believe that the Commission should add an exception to the review and approval requirement for social media posts due to the nature and purpose of those advertisements.
- Bullet point five asks if the Commission should require any specific compliance procedures in the Advertisement Rule in addition to review and approval. We wholeheartedly believe that there should <u>not</u> be specific procedures promulgated by the Commission. Specific procedures are contrary to a principles-based law like the Advisers Act and should remain within the purview of the investment adviser.

Portability of Performance

The Discussion also requests comment about another challenge that investment advisers have in maintaining compliance with the Advertisement Rule. Investment advisers frequently want to advertise the performance results of portfolios they managed prior to joining their current firm. Provided that the use of the performance would not be misleading, investment advisers often struggle to access the requisite books and records of the predecessor firm to substantiate the performance results. In general, that information is not available to the adviser due to contractual or privacy restrictions.

The Commission requested comment on a number of aspects of the proposal, including amendments to the Advisers Act books and records rule to address substantiation of the predecessor results. Due to the challenges in accessing the substantiation, we recommend that the Commission consider two options that we believe will meet the need for consumer protection while allowing investment advisers to use prior performance that is helpful to prospective clients.

First, we recommend that investment advisers be allowed to create a representative composite based upon data that they can obtain after departing their predecessor firm. For example, the investment adviser may

[11] The Amendments at 84 Fed. Reg. 67569

be able to get a proper sampling of client statements that would allow for them to re-create the performance with proper substantiation. While the sampling would not include all accounts that were part of the portfolio, the sampling would allow the Commission to verify the performance. Of course, the sampling must be a true representation of the prior results and not be misleading.

Second, or alternatively, we recommend that investment advisers be allowed to use performance advertised by the predecessor firm provided the investment adviser has a copy of the previous advertisement of the predecessor firm and the predecessor was subject to the Advertisement Rule and Rule 204-2. The investment adviser could rely upon the previous advertisement being properly calculated. The Commission would, of course, be able to examine the results of the predecessor firm for so long as the data needs to be maintained by that firm. This practice is consistent with the manner in which the Commission currently verifies assets with third party custodians.

THE SOLICITATION AMENDMENTS

Background on Solicitation

In addition to advertising, certain investment advisers attract clients through compensating either firms or individuals to solicit new investors on their behalf ("Solicitors").[12] Solicitors have an incentive to recommend the investment adviser and, without appropriate disclosure, an investor could rely on that recommendation without knowledge that the Solicitor was compensated for the recommendation. Currently the Solicitation Rule ensures that investors are aware of that conflict when compensation is in the form of cash. However, in the forty years since the Commission adopted the Solicitation Rule, non-cash compensation has become more common than it was.

We believe that the Solicitation Amendments generally strikes an appropriate balance between protecting investors and permitting investment advisers to effectively utilize Solicitors to grow their business. The Solicitation Amendments expand the rule to include non-cash compensation, an update that aligns with current business practices, while eliminating certain requirements that are redundant and awkward. By lifting some of the requirements, especially those that seemed unnecessary and inefficient, the new rule will be easier to follow while maintaining the same investor protections. We support these measures.

Revisions to the Solicitation Rule's De Minimis Exception

We support the concept of adding a *de minimis* compensation exception to the rule, in part, for the same reasons the Discussion gives for the *de minimis* exception: to accommodate the trend towards the use of client solicitation and referral programs.[13] The Commission asks for further comment on what the amount of the *de minimis* exception should be and how it should be calculated. We support calculating the exception over a trailing twelve month period to prevent abuse. We do not feel that this method would add much to investment advisers' compliance burdens because we agree with the Commission that investment advisers should be keeping records of these payments. However, we find that $100 is an inadequate amount.

In our experience, the dollar amount in client referral programs often exceeds $100. For example, investment advisers may offer to offset a quarter's worth of a client's advisory fees in return for a recommendation that leads to a new client. We think that the Commission should take a more principles-based approach to setting the exception, especially since, over time, the value of a set dollar amount will diminish. Providing an exception for payments made to existing clients for referrals would be a clearer and more direct way to implement the *de minimis* exception's intent. Of course, this could invite abuse where a solicitor engages the investment adviser for a nominal service, but this would be a violation of Section 208(d) of the Advisers Act which makes it unlawful to do something indirectly that would be unlawful if

[12] The Amendments at 84 Fed. Reg. 67521
[13] The Amendments at 84 Fed. Reg. 67572

done directly. Furthermore, the Commission can limit the amount of the *de minimis* exception to a specified percentage of the fees the client is charged by the investment adviser over a trailing twelve month period.

Exemption from the Definition of Investment Adviser for Solicitor

A challenge that investment advisers often have in entering into a solicitation relationship is the potential registration requirements of the Solicitor. Because the Solicitor is not a supervised person of the investment adviser, that Solicitor can be subject to state rules and regulations that may require that Solicitor to register in some capacity (as an investment adviser or investment adviser representative). If such registration makes sense, it's only for those Solicitors that are in the regular business of soliciting clients for investment advisers. However, for those engaged in single or infrequent solicitation activity, such registration is unduly burdensome. A client that recommends that some of their friends engage their investment adviser should not have to register as an investment adviser themselves.

We encourage the Commission to adopt a provision to the Solicitation Amendments that would permit investment advisers to consider participants in such programs supervised persons as defined in Section 202(a)(25) of the Advisers Act for the limited purpose of ensuring that the Solicitor acts in a manner that is consistent with the solicitation agreement. So long as the Solicitor limits its activities to those that would not otherwise meet the Advisers Act definition of investment adviser representative in Rule 203A-3, the Solicitor would be exempt from state and federal registration.

CONCLUSION

We believe that the Advertisement and Solicitation Amendments are substantially positive developments, taking a principles-based approach and updating regulations to better serve investment advisers and consumers. The proposed changes will achieve the Commission's intent of modernizing the rules to, "reflect changes in technology, the expectations of investors seeking advisory services, and the evolution of industry practices."[14]

We urge the commission to reconsider the proposed review and approval requirement to the Advertisement Amendments.[15] We believe that this requirement will add burdens on investment advisers of all sizes and have the impact of constricting communications, causing them to be less effective. In our opinion, this requirement is contrary to the intended effect of the rest of the Advertisement Amendments and provides limited protections for consumers. We also recommend that the Commission provide a solution for investment advisers that wish to advertise performance from a predecessor firm where they cannot obtain all of the substantiation currently required to advertise such prior performance.

With regard to the Solicitation Amendments, we urge the Commission to increase the proposed amount of the *de minimis* compensation exception. We recommend that the Commission take a more principles-based approach in setting the allowable amount under the standard. This might include a higher *de minimis* exception where the Solicitor is a current client of the investment adviser. We also request that the Commission consider an interpretation that would allow limited Solicitors, such as clients of an investment adviser making infrequent referrals, to avoid state registration as an investment adviser.

We hope that our comments, made on behalf of us and our entrepreneurial, independent investment adviser clients are beneficial to the rulemaking process. Thank you for the opportunity to provide constructive input. Should you have any questions or require any additional information regarding any of the foregoing, we remain available at your convenience.

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[14] Press Release: SEC Proposes to Modernize the Advertising and Cash Solicitation Rules for Investment Advisers." SEC.gov, U.S. Securities and Exchange Commission, 4 Nov. 2019, www.sec.gov/news/press-release/2019-230.

[15] The Amendments at 84 Fed. Reg. 67569

Best regards,
MARKETCOUNSEL CONSULTING, LLC

By: 

Brian Hamburger, JD, CRCP
President and CEO

Daniel Bernstein
Chief Regulatory Counsel