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February 10, 2020

VIA ELECTRONIC SUBMISSION

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Request for Comment Regarding SEC Release No. IA-5407 (File Number S7-21-19): Investment Adviser Advertisements; Compensation for Solicitations

Dear Ms. Countryman:

Fried, Frank, Harris, Shriver & Jacobson, LLP ("**Fried Frank**") respectfully submits this letter in response to a request by the Securities and Exchange Commission (the "**Commission**") for comments regarding the above referenced release (the "**Proposing Release**"), in which the Commission proposed certain amendments to (i) Rule 206(4)-1 ("**Advertising Rule**") under the Investment Advisers Act of 1940, as amended ("**Advisers Act**") and (ii) Rule 206(4)-3 under the Advisers Act ("**Solicitation Rule**").[1] We recognize the time and effort invested by the Commission and the Staff of the Division of Investment Management ("**Staff**") in formulating the Proposing Release and appreciate the opportunity to comment.

Fried Frank is an international law firm with offices in New York, Washington, D.C., London, and Frankfurt. Our clients include many advisers to alternative investment funds, and we regularly counsel clients with respect to structuring and operating their investment advisory businesses in compliance with their legal and regulatory obligations. These comments, while informed by our experience in representing these clients, represent Fried Frank's own views and are not intended to reflect the views of our clients.

I. Introduction

On November 4, 2019, the Commission published proposed amendments to the Advertising Rule and the Solicitation Rule. The Commission's proposed amendments to the Advertising Rule acknowledge developments in technology, changing profiles of investment advisers, and the Commission's experience administering the current rule, and seek to modernize the rule with an evergreen definition of "advertisement" and a principles-based approach to compliance.[2] The

[1] Investment Adviser Advertisements; Compensation for Solicitations, 84 Fed. Reg. 67518 (Dec. 10, 2019).

[2] Proposing Release at 67519.

Commission's proposed amendments to the Solicitation Rule are intended to reflect regulatory changes and the evolution of industry practices since the rule was initially adopted, and to eliminate certain existing requirements where the purpose of the requirements can be achieved under other Advisers Act rules.[3]

We appreciate the Commission's efforts to modernize and streamline the Advertising Rule and the Solicitation Rule, which have not been substantively changed since their adoption in 1961 and 1979 respectively, and we respectfully submit the following comments with respect to the Proposing Release:

(i) The Commission should address portability of performance by adopting a principles-based approach with a focus on disclosure;
(ii) The Commission should disregard non-U.S. investors in funds organized outside of the United States for purposes of determining whether a non-retail advertisement can be disseminated to fund investors;
(iii) The Commission should limit the application of the Prescribed Time Period Requirement to open-end private funds (in each case, as defined below);
(iv) The Commission should clarify that if a statement in an adviser's advertisement is appropriately phrased as a belief or an opinion and the adviser reasonably believes the statement, the statement would not be considered "unsubstantiated" for purposes of subparagraph (a)(2) of the proposed Advertising Rule; and
(v) The Commission should not expand the Solicitation Rule to apply to non-cash compensation or the solicitation of private fund investors.

We discuss each of the foregoing in turn below.

II. Advertising Rule

A. <u>The revised Advertising Rule should include a provision that specifically addresses the presentation of predecessor performance and should allow advisers to advertise predecessor performance if certain conditions are satisfied.</u>

While the proposed Advertising Rule does not explicitly address the ability of investment advisers to advertise performance results achieved at a different entity ("**predecessor performance**"), the Commission requests comments on whether the revised rule should include specific provisions to address predecessor performance, or whether the proposed Advertising Rule, including the provisions of paragraph (a), would sufficiently prevent the presentation of predecessor performance that is false or misleading.[4] We believe that the revised Advertising Rule should include a specific provision to address the presentation of predecessor performance. As discussed below, we believe that an investment adviser should be able to advertise predecessor performance if the adviser (i) adopts policies and procedures reasonably designed to ensure that the predecessor performance is relevant to the investment objectives of the recipient of the advertisement; (ii) provides sufficient information to enable the recipient to understand the performance returns

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[3] *Id*. at 67518, 67571.

[4] *Id*. at 67567.

achieved at the predecessor firm, including how investment decisions were made and the criteria used and assumptions made in calculating the predecessor performance; and (iii) 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 predecessor performance in making investment decisions. These conditions would effectively mirror the conditions in paragraph (c)(1)(v) of the proposed Advertising Rule, which permits an investment adviser to advertise hypothetical performance if it satisfies the conditions set forth therein.

As the Commission notes in the Proposing Release, an investment adviser may seek to advertise predecessor performance when it spins out from another adviser, or when it hires investment personnel who established their performance record while employed by another investment adviser.[5] Such predecessor performance, the Commission recognizes, may be directly relevant to an audience when the advertisement offers services to be provided by the personnel responsible for the predecessor performance, even when the personnel did not work for the adviser disseminating the advertisement ("**advertising adviser**") during the period for which performance is being advertised.[6] The Commission also recognizes that an advertising adviser may present predecessor performance in a false or misleading manner by, for example, presenting predecessor performance when the team that was primarily responsible for the predecessor performance is different from the team whose advisory services are being offered or promoted, or by presenting predecessor performance without disclosing that the predecessor performance was achieved by different personnel, or by a different advisory entity, than the personnel or entity whose services are being offered or promoted.[7]

We agree with the Commission that predecessor performance can be directly relevant to the recipient of an advertisement, and we also agree with the Commission that predecessor performance raises concerns if presented in a false or misleading manner. In our view, a principles-based, disclosure-driven approach would allow advisers to provide investors with relevant predecessor performance while also addressing the Commission's concerns that such predecessor performance could be false or misleading to investors. In particular, we believe that the same approach that the Commission proposes for advertising hypothetical performance would provide the appropriate framework for advertising predecessor performance, and it would promote the Commission's overall goal of revising the Advertising Rule to be more principles-based.

Under the three-pronged principles-based approach, investment advisers would first need to have policies and procedures reasonably designed to ensure that predecessor performance is relevant to the investment objectives of the recipient. This would mean, for instance, that an adviser would not be able to advertise predecessor performance if the investment strategy of the predecessor performance has no relevance to the prospective investor. Next, investment advisers would need to provide sufficient information to enable the recipient to understand the predecessor performance. This would include information about how investment decisions were made at the predecessor firm, as well as what criteria and assumptions were taken into account in calculating the performance returns. If investment decisions were made by a committee, for instance,

[5] *Id*. at 67566.

[6] *Id*.

[7] *Id*.

investment advisers would need to disclose how many members were on the investment committee, what role each member played, and whether there were non-investment committee personnel who also played a role in the investment process. Finally, investment advisers would need to provide (or offer to provide promptly if the recipient is a non-retail person) sufficient information to enable the recipient to understand the risks and limitations of using predecessor performance in making investment decisions. This would include, for example, that the predecessor performance was not achieved by the advertising adviser, and if applicable, that the investment personnel at the advertising adviser are not identical to the investment personnel that achieved the predecessor performance and that investment personnel of the advertising adviser could change over time. We believe that this principles-based, disclosure-focused approach would allow investors to receive valuable, pertinent information that could be significant to their decision in hiring an investment adviser. At the same time, we believe that the approach would also prevent investment advisers from advertising predecessor performance in a misleading manner by requiring that they satisfy specific conditions, in addition to the general provisions of paragraph (a), before they can advertise predecessor performance.

We believe that our suggested approach would resolve many of the challenges that advisers currently face with respect to predecessor performance. Given that the Advertising Rule does not address predecessor performance (or performance generally), investment advisers today rely on Staff no-action letters to advertise predecessor performance.[8] Under current Staff guidance, investment advisers seeking to advertise predecessor performance must satisfy a number of conditions, including that the individuals that manage the accounts at the advertising adviser are the same individuals that were "primarily responsible" for achieving the performance results at the predecessor firm. This condition poses a significant challenge because the Staff has not specifically defined what it means to be "primarily responsible," and when a committee is in charge of making investment decisions, it can be extremely difficult to determine which members were "primarily responsible." In this regard, the Staff has stated that, when investment decisions are made by a committee, predecessor performance can only be used if there is a "substantial identity of personnel" among the investment committee of the predecessor firm and the investment committee of the advertising adviser.[9] While this standard does not require the committees at the predecessor firm and successor firm to be identical, the Staff has not provided guidance on what constitutes a "substantial identity" of personnel. In addition, the Staff has said that it would be misleading for an advertising adviser to use predecessor performance if individuals that are not part of the investment decision-making process at the advertising adviser played a "significant role" in the investment decision-making process at the predecessor firm.[10]

[8] *See generally* South State Bank, SEC Staff No-Action Letter (pub. avail. May 8, 2018); Horizon Asset Management LLC, SEC Staff No-Action Letter (pub. avail. Sept. 13, 1996); Bramwell Growth Fund, SEC Staff No-Action Letter (pub. avail. Aug. 7, 1996); Taurus Advisory Group, Inc., SEC Staff No-Action Letter (pub. avail. Jul. 15, 1993); Great Lakes Advisers, Inc., SEC Staff No-Action Letter (pub. avail. Apr. 3, 1992) ("**Great Lakes Advisers**"); and Conway Asset Management, Inc., SEC Staff No-Action Letter (pub. avail. Jan. 27, 1989) ("**Conway**").

[9] Great Lakes Advisers at n. 4.

[10] Great Lakes Advisers; Conway; Fiduciary Management Associates, Inc., SEC Staff No-Action Letter (pub. avail. Feb. 16, 1984) ("**Fiduciary Management**"). *See also* Proposing Release at 67566.

In seeking to establish an appropriate standard for allowing investment advisers to advertise predecessor performance, the Staff's guidance has also raised uncertainties around the application of these subjective standards. The Commission seeks comment on how "primary responsibility" should be determined if it were to require that the individuals who manage accounts at the advertising adviser were "primarily responsible" for achieving the predecessor performance at the prior firm. The Commission also seeks comment on whether it should define or provide additional guidance regarding "substantial identity" if it were to require that accounts at the advertising adviser be managed by a committee comprising a substantial identity of the membership at the predecessor firm. Rather than seeking to draw clear lines around these subjective standards, we respectfully urge the Commission to adopt a principles-based approach that focuses on disclosure. We believe this would be consistent with the industry's best interest, as it would allow advisers to provide, and investors to receive, not only the information that advisers can provide when they satisfy the conditions imposed by "primary responsibility" or "substantial identity" (however such terms may be defined or interpreted) but also all other information that could be important in assessing an investment adviser's services.

We believe that a principles-based approach would also eliminate additional challenges investment advisers encounter under current Staff guidance. Often, even if investment advisers initially satisfy all of the applicable conditions for using predecessor performance, they still face challenges in due course because individuals who were on the predecessor firm's investment committee eventually depart, retire, or die following the transition to the advertising adviser, and committee members may be added or replaced by the advertising adviser. Moreover, when investment advisers experience a change in ownership, the ability to use predecessor performance can differ drastically depending on whether the change in ownership is achieved through the purchase of the adviser or the purchase of the adviser's assets. In the former, the target adviser continues to exist and can continue to use its performance record. In the latter, the acquiring adviser is prohibited from using the target adviser's performance history unless it is able to satisfy the conditions of the Staff's guidance. This difference in result seems inconsistent with the Commission's stated view in the Proposing Release that a mere change in ownership of the adviser likely would not render the use of predecessor performance misleading.[11] We believe that a disclosure-focused, principles-based approach would eliminate these issues and the industry would benefit from a more consistent, transparent, and logical result under our suggested approach.

Although we believe that with appropriate disclosures, the use of predecessor performance should not be misleading even to retail investors, we appreciate the Commission's focus on protecting such investors, who may have limited access to analytical and other resources to enable them to analyze predecessor performance information.[12] If the Commission believes that the use of predecessor performance would be misleading to such investors even under the conditions we propose (which, as noted above, mirror those the Commission proposes for hypothetical performance), we respectfully ask the Commission to consider permitting the use of predecessor performance in non-retail advertisements, subject to the proposed conditions. The proposed Advertising Rule defines non-retail advertisements to mean advertisements for which an adviser has adopted and implemented policies and procedures reasonably designed to ensure that the

[11] Proposing Release at 67567 n. 329.

[12] Proposing Release at 67544.

advertisements are disseminated solely to non-retail persons, and non-retail persons to mean qualified purchasers or knowledgeable employees (in each case, as defined in the Investment Company Act).[13] The Commission states in the Proposing Release that non-retail persons have access to analytical and other resources to analyze performance advertising.[14] These resources can also enable non-retail persons to evaluate the complexities, nuances and limitations associated with the presentation of predecessor performance information. As a result, and if the revised rule also required advertising advisers to include appropriate disclosure regarding the predecessor performance, the likelihood that a non-retail investor would be misled by the use of predecessor performance is low. Meanwhile, such non-retail investors would be afforded the benefit of receiving pertinent information that could be material in helping them consider their investment opportunities.

B. Non-U.S. investors in a 3(c)(7) Fund organized outside of the United States should be disregarded when determining whether a non-retail advertisement can be disseminated to the 3(c)(7) Fund's investors.

The proposed amendments to the Advertising Rule establish two sets of standards for the presentation of performance information: one for non-retail advertisements and another for retail advertisements.[15] As mentioned above, the Commission proposes to define "non-retail person" by reference to the types of persons eligible to invest in a private fund relying on the exclusion from registration as an investment company under section 3(c)(7) of the Investment Company Act ("**3(c)(7) Fund**") -- i.e., qualified purchasers and knowledgeable employees.[16] This suggests that the Commission intended for advertisements by advisers to investors and potential investors in 3(c)(7) Funds generally to be considered non-retail advertisements, because generally, all investors in a 3(c)(7) Fund are required to be qualified purchasers or knowledgeable employees. However, many advisers to 3(c)(7) Funds organized outside of the United States rely on the Staff guidance set forth in the *Goodwin Procter* no-action letter and do not limit non-U.S. investors to qualified purchasers.[17] The Proposing Release does not specifically address how non-U.S. investors in a fund organized outside of the United States would be treated under the bifurcated standard in the proposed Advertising Rule. As a result, unless an adviser to a 3(c)(7) Fund organized outside of the United States obtained qualified purchaser representations from all non-U.S. investors (which,

[13] Proposed rule 206(4)-1(e)(7) and (e)(8). The proposed Advertising Rule defines retail advertisements to mean advertisements other than a non-retail advertisement, and retail persons to mean persons other than a non-retail person. Proposed rule 206(4)-1(e)(13) and (e)(14).

[14] Proposing Release at 67547, 67549.

[15] For example, any retail advertisement that shows gross performance would also be required to include net performance with at least equal prominence and in a format designed to facilitate comparison with gross performance. Proposed rule 206(4)-1(c)(2)(i)(A). In addition, performance results would be prohibited in a retail advertisement unless the advertisement includes performance results of the same portfolio for one-, five- and ten- year periods, each presented with equal prominence and ending on the most recent practicable date, with an exception for portfolios not in existence during a particular prescribed period. Proposed rule 206(4)-1(c)(2)(ii).

[16] Proposed rule 206(4)-1(e)(7).

[17] Goodwin, Procter & Hoar, SEC Staff No-Action Letter (pub. avail. Feb. 28, 1997) ("**Goodwin Procter**").

as described above, many advisers do not),[18] the adviser may have to treat advertisements to the fund investors as retail advertisements, or create two versions of each advertisement–one for investors that are non-retail persons and one for investors that are deemed to be retail persons. Both options would impose an undue burden on advisers to such non-U.S. funds. Therefore, we encourage the Commission to clarify that non-U.S. investors in a 3(c)(7) Fund organized outside of the United States should be disregarded when determining whether a non-retail advertisement can be disseminated to the 3(c)(7) Fund's investors.

We appreciate the Commission's focus on preventing investment advisers from presenting performance results in a way that is likely to mislead retail persons.[19] We respectfully submit, however, that disregarding non-U.S. investors in non-U.S. 3(c)(7) Funds for purposes of determining whether a non-retail advertisement can be disseminated to the 3(c)(7) Fund's investors should not create significant regulatory concerns. Non-U.S. investors in a 3(c)(7) Fund organized outside of the United States generally do not purchase securities issued by the 3(c)(7) Fund in a U.S. private offering expecting to receive the protections afforded by the U.S. securities laws. In addition, rule 206(4)-8 under the Advisers Act would apply to any advertisement by an adviser to non-U.S. investors in non-U.S. 3(c)(7) Funds.[20] We believe that rule 206(4)-8 should provide adequate protection to non-U.S. investors in non-U.S. 3(c)(7) Funds such that advisers should be permitted to disseminate non-retail advertisements to such investors under the proposed Advertising Rule. Moreover, the laws of many non-U.S. jurisdictions impose their own qualification requirements on investors in non-U.S. 3(c)(7) Funds who are resident of or marketed to in such jurisdictions in order to ensure that those investors have a certain level of sophistication and have the ability to bear the risk of investing in private funds. For example, investors in the European Economic Area must represent that they have the experience, knowledge and expertise to make their own investment decisions and assess the risks of investing in a private fund. Non-U.S. investors meeting such qualification requirements would be considered sufficiently sophisticated by their home jurisdictions that they do not need the protections afforded to investors lacking such sophistication or ability to bear the risk of investing in private funds. For those reasons, we believe that the concerns underlying the use of performance information in advertisements to retail investors would be significantly mitigated with respect to non-U.S. investors in non-U.S. 3(c)(7) Funds.

Based on the foregoing, we respectfully encourage the Commission to clarify that non-U.S. investors in funds organized outside of the United States will be disregarded for purposes of determining whether a non-retail advertisement can be disseminated to fund investors. However, if the Commission determines not to disregard non-U.S. investors in funds organized outside of the United States for purposes of determining whether a non-retail advertisement can be disseminated to fund investors, we respectfully request that the Commission consider permitting existing 3(c)(7) Funds organized outside of the United States to disregard their non-U.S. investors

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[18] The adviser likely has information readily available to determine the knowledgeable employee status of its non-U.S. person employees invested in the fund.

[19] Proposing Release at 67546.

[20] Rule 206(4)-8 prohibits investment advisers from making false or misleading statements to, or otherwise defrauding investors and prospective investors in a pooled investment vehicle, and applies to both U.S. and non-U.S. advisers with respect to U.S. and non-U.S. investors in both U.S. and non-U.S. pooled investment vehicles.

for purposes of determining whether a non-retail advertisement can be disseminated to fund investors.

C. Application of the Prescribed Time Period Requirement should be limited to private funds that (i) have unlimited duration, (ii) primarily own securities with a readily determinable market value, (iii) offer investors periodic redemptions, and (iv) show performance using time-weighted rates of return.

The proposed amendments to the Advertising Rule would require retail advertisements that show performance information to include results of the applicable portfolio for one-, five-, and ten-year periods (or the life of the portfolio, where applicable), and to present the results for each prescribed time period with equal prominence ending on the most recent practicable date (the "**Prescribed Time Period Requirement**").[21] While we understand that showing performance for these specified time periods can provide valuable perspective for certain portfolios, as discussed below, it presents a problem for private funds that do not issue redeemable securities (including private equity funds, energy funds, infrastructure funds, and real estate funds) ("**closed-end private funds**"), which we believe was not the Commission's intention. As a result, we respectfully urge the Commission to limit the application of the Prescribed Time Period Requirement to private funds that (i) have unlimited duration, (ii) primarily own securities with a readily determinable market value, (iii) offer investors periodic redemptions, and (iv) show performance using time-weighted rates of return ("**open-end private funds**").[22]

Closed-end private funds typically concentrate their investments in illiquid assets, which do not have a readily determinable market value, and have a fixed life, often 10 to 15 years. Investors in closed-end private funds generally make a capital commitment to the fund and that capital is drawn down by the fund and invested over time, often two to three years. In addition, as the term of the fund draws to a close, the assets are harvested and the fund returns the proceeds to investors. Due to their long-term investment horizon and fixed term, closed-end private funds do not offer any redemption rights to investors. In addition, because the adviser to a closed-end private fund controls the timing of cash flows from investors (calling capital) and cash flows to investors, closed-end private funds calculate performance using an internal rate of return ("**IRR**"), a performance metric that takes into account the timing of cash flows from and to investors. The IRR of a closed-end private fund is often not meaningful in the early years of the fund because the fund is not fully-invested, no investments have been harvested and the new investments likely have not changed in value.[23] Presenting performance information that is not meaningful or representative of the expected performance over time could be more misleading than helpful to investors.

[21] Proposed rule 206(4)–1(c)(2)(ii).

[22] We recognize that the term "open-end" has certain implications under the Investment Company Act, and that most of the private funds we refer to as "open-end private funds" herein would not be deemed "open-end" for purposes of the Investment Company Act.

[23] We recognize that there is a potential for investment advisers to cherry-pick or otherwise mislead investors by using "not meaningful" to show performance information (e.g., if they do not consistently use "not meaningful" and only use it to disguise poor performance). We regularly advise our clients that "not meaningful" should be used consistently, pursuant to reasonably designed policies and procedures, and only with appropriate disclosures.

Unlike closed-end private funds, open-end private funds typically invest in publicly-traded securities with a readily determinable market value and offer investors periodic subscription and redemption opportunities. Due to the availability of periodic subscriptions and redemptions, an open-end private fund does not control the flow of money between the fund and the investors. As a result, open-end private funds typically calculate performance using a time-weighted return method which has the effect of stripping out the impact of any cash flows and is independent of the total amount invested in the fund at any given time. Therefore, open-end private funds typically calculate performance on a monthly basis and can show meaningful one, five and ten-year returns.

We believe that these differences between open-end and closed-end private funds, many of which have been recognized by the Commission in the past,[24] justify a determination to apply the Prescribed Time Period Requirement to only open-end private funds. This would be consistent with the application of rule 482 under the Securities Act of 1933, as amended, (the "**Securities Act**"), which appears to be the Commission's justification for proposing the Prescribed Time Period Requirement.[25] Rule 482 requires average annual total returns be provided for one-, five-, and ten-year periods only for securities of open-end companies registered under the Investment Company Act.[26]

D. A statement in an adviser's advertisement that is appropriately phrased as a belief or an opinion should not be considered "unsubstantiated" for purposes of subparagraph (a)(2) provided that the adviser reasonably believes the statement.

Subparagraph (a)(2) of the proposed Advertising Rule would prohibit material claims and statements that are "unsubstantiated."[27] Neither the proposed rule nor the Proposing Release defines what it means for a claim to be unsubstantiated. Therefore, it is possible that subparagraph (a)(2) could be interpreted to require that an adviser have empirical evidence to support each statement in an advertisement, including statements of opinion or belief. While we believe that investment advisers generally should not be permitted to include unwarranted or unsubstantiated statements of fact in advertisements, we do not believe that they should be required to have empirical evidence to support statements of opinion or belief. To this end, we respectfully ask the Commission to clarify, either in the revised Advertising Rule or in the release adopting a revised Advertising Rule, that a statement in an adviser's advertisement that is appropriately phrased as a belief or an opinion would not violate the revised Advertising Rule, provided that the adviser reasonably believes the statement, and that empirical evidence or specific source citations should not be required with respect to such statements.

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[24] Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72054, 72055, 72072 n. 224 (Dec. 10, 2004).

[25] Proposing Release at 67553 n. 265 ("We require average annual total return for 1-, 5-, and 10-year periods for advertisements with respect to securities of certain RICs and BDCs. See 17 CFR 230.482(d)(3). We believe a similar requirement for Retail Advertisements would provide useful reference points for Retail Persons, particularly when comparing two or more sets of performance results.").

[26] *See* Securities Act rule 482(d)(3).

[27] Proposed rule 206(4)-1(a)(2) ("**subparagraph (a)(2)**").

We believe these clarifications would be consistent with the Commission's policy goals of prohibiting fraud and false and misleading statements in advertisements.[28] The Commission states in the Proposing Release that rule 156 under the Securities Act and Financial Industry Regulatory Authority ("**FINRA**") rule 2210 contain provisions similar to subparagraph (a)(2).[29] We note that unlike subparagraph (a)(2), which prohibits advertisements that include a material claim or statement that is unsubstantiated, rule 156 provides a non-exhaustive list of factors to consider in determining whether a particular statement involving a material fact is or might be misleading. Rule 156(b)(3) provides that "a statement involving a material fact about the characteristics or attributes of an investment company could be misleading because of … (ii) exaggerated or unsubstantiated claims about management skill or techniques, characteristics of the investment company or an investment in securities issued by such company, services, security of investment or funds, effects of government supervision, or other attributes." Therefore, under Rule 156, whether a claim is unsubstantiated is one factor among various others that should be considered in determining whether a statement is misleading, and it is possible for an adviser to conclude that a statement of opinion or belief that it reasonably believes is true is not misleading, even if such statement is not supported by empirical evidence. Further, we note that FINRA rule 2210 does not make any reference to "unsubstantiated" statements. Instead, it prohibits "false, exaggerated, unwarranted, promissory, or misleading" statements or claims.[30] Thus, under FINRA rule 2210, the fact that a statement of opinion or belief is not supported by empirical evidence does not necessarily mean that the statement is "unwarranted" or "exaggerated," if the adviser reasonably believes it is a true statement. Consistent with the Commission's statement that these provisions are similar to subparagraph (a)(2), we believe that the revised Advertising Rule should permit investment advisers to make statements of belief or opinion in the same manner as they are able to under the "similar" provisions of rule 156 and FINRA Rule 2210.

III. Solicitation Rule

A. <u>The Solicitation Rule should not be expanded to apply to non-cash compensation and the solicitation of private fund investors because such an application would be overly broad and would impose an undue burden on registered investment advisers subject to the rule.</u>

The Commission proposes to expand the Solicitation Rule to (i) cover solicitation arrangements involving all forms of compensation, rather than only cash compensation[31] and (ii) apply to the solicitation of existing and prospective private fund investors.[32] These proposals represent a considerable expansion from the current application of the Solicitation Rule and will have

[28] Proposing Release at 67519, 67532.

[29] Proposing Release at 67532.

[30] FINRA rule 2210(d)(1)(A).

[31] Proposed rule 206(4)-3(a). *See also* Proposing Release at 67572-73. In the Proposing Release, the Commission defines non-cash compensation broadly, to include directed brokerage, refer-a-friend programs, sales awards or other prizes, training or education meetings, outings, tours, or other forms of entertainment, and free or discounted advisory services, providing investment advice that directly or indirectly benefits the solicitor, free attendance at training and education meetings provided in exchange for solicitation activities. *Id.*

[32] Proposed rule 206(4)-3.

significant consequences to the structuring and operation of relationships between investment advisers and solicitors. We therefore urge the Commission to limit the application of the Solicitation Rule to cash compensation and advisory clients (which would not include investors in private funds).

1. Non-Cash Compensation

While we understand the Commission's concerns that non-cash compensation for referrals creates the same conflicts of interest as cash compensation for referrals,[33] such an expansion would render the rule overly broad and would in practice impose an undue burden on registered investment advisers subject to the rule.

Many investment advisers have numerous business relationships with other parties that involve the provisions of products and services in both directions between the parties, but that are not intended to reward the other party for any client referral. Such relationships often do not involve cash compensation and are not memorialized in written agreements, and are simply ordinary course, ongoing business relationships. While these relationships may well warrant conflicts disclosure (which our clients already include in both their Forms ADV and fund offering materials), we believe that the proposed Solicitation Rule would create an impossible framework for the financial industry. Under the proposed Solicitation Rule, an unanticipated client referral to an investment adviser could violate the proposed rule if the adviser has previously provided non-cash compensation to the referral source through another business relationship because the adviser and the referral source did not enter into the written agreement or provide the separate disclosure required by the proposed rule.[34] As a result, in order to avoid inadvertent violations of the proposed Solicitation Rule (and unless an exemption were available), an adviser would be forced to preemptively enter into the required written agreements in connection with all of its business relationships (including with parties who are not solicitors and may have no current expectations of ever soliciting or referring clients to the adviser), in anticipation of a future referral. This could harm an adviser's financial industry relationships, because business counterparties who are not solicitors and have no expectation of conducting any solicitation or referral activities may be unwilling to enter into such written agreements or prepare such separate disclosures. As a result, we believe that any incremental benefit from an expansion of the Solicitation Rule to non-cash compensation would be far outweighed by the significant cost to the investment advisory industry.

2. Private Fund Investors

We acknowledge the Commission's desire to protect private fund investors primarily by making them aware of a solicitor's financial interest in the investor's investment in a private fund and prohibiting the use of disqualified solicitors under the proposed rule.[35] However, we urge the Commission to exclude private fund investors from application of the Solicitation Rule because we believe that private fund investors are sufficiently financially sophisticated to understand the conflicts involved with solicitor relationships and already receive adequate protections under other

[33] Proposing Release at 67572.

[34] Proposed rule 206(4)-3(a)(1).

[35] Proposing Release at 67573.

U.S. securities laws. Private fund investors generally have a high level of financial sophistication due to the investor eligibility requirements associated with private securities offerings. More importantly, private fund investors receive extensive conflicts disclosures in the offering documents of the relevant private fund, including with respect to conflicts of interest arising from paid solicitation arrangements (whether for cash or non-cash compensation). Requiring the delivery of a separate disclosure regarding such solicitation arrangements would be duplicative, especially because private fund investors receive relevant disclosures in offering materials *prior to* making an investment in the fund. This is distinguishable from non-private fund investors that receive conflicts disclosure in the Form ADV, which can be delivered up until the time that an adviser enters into an investment advisory agreement with a client[36] and is designed to disclose the adviser's conflicts rather than the solicitor's conflicts.[37] Moreover, private fund investors are sufficiently protected by other provisions of U.S. securities laws. Section 206(4) of the Advisers Act prohibits investment advisers from generally engaging in conduct that is fraudulent, deceptive, or manipulative, and rule 206(4)-8 thereunder specifically prohibits investment advisers to pooled investment vehicles[38] from engaging in fraudulent, manipulative or deceptive conduct with respect to investors or prospective investors in the pooled investment vehicle. In addition, section 10(b) of the Securities Exchange Act of 1934, as amended, and rule 10b-5 thereunder, prohibit fraud in connection with the purchase or sale of any security, which includes interests in private funds. These existing protections serve to ensure that investment advisers do not engage in fraudulent conduct, including with respect to paid solicitation arrangements.

For the reasons stated above, we believe that the Solicitation Rule should not be expanded to apply to non-cash compensation and the solicitation of private fund investors.

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We appreciate the opportunity to comment on the proposed amendments to the Advertising Rule and the Solicitation Rule. If the Commission or its Staff have any questions or wish to discuss the matters mentioned in this letter, please contact Jessica Forbes at 212-859-8558 or Jessica.Forbes@friedfrank.com.

Very Truly Yours,

Fried, Frank, Harris, Shriver & Jacobson LLP

[36] *See* Advisers Act Rule 204-3(b)(1).

[37] *See* Proposing Release at 67574 ("While advisers themselves are required to disclose to clients their compensation arrangements, including compensation for client referrals and the related conflicts of interest, we believe that the separate solicitor disclosure to investors would put investors on notice of the solicitor's conflict of interest in the compensated solicitation arrangement.").

[38] The definition of "pooled investment vehicle" for this purpose includes private funds (i.e., any company that would be an investment company under section 3(a) of the Investment Company Act but for the exclusion provided from that definition by either section 3(c)(1) or section 3(c)(7) of the Investment Company Act).