SIDLEY

SIDLEY AUSTIN LLP
787 SEVENTH AVENUE
NEW YORK, NY 10019
+1 212 839 5300
+1 212 839 5599 FAX

AMERICA • ASIA PACIFIC • EUROPE

February 10, 2020

VIA E-MAIL

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549
Attn: Ms. Vanessa Countryman, Secretary

Re: Investment Adviser Advertisements; Compensation for Solicitations–File No. S7-21-19

We appreciate the opportunity to comment on the proposals of the Securities and Exchange Commission (the "Commission") set forth in the above-referenced release.[1] While we strongly support the Commission's initiative to modernize the rules under the Investment Advisers Act of 1940 (the "Advisers Act") addressing investment adviser advertisements and payments to solicitors, we have comments and concerns with respect to certain aspects of the proposals set forth in the Proposing Release, as discussed below. The comments in this letter reflect the views of a group of lawyers in our firm that regularly advise investment advisers. While we have discussed certain matters in the Proposing Release with some clients and colleagues, we are not making these comments on behalf of any client, and our comments do not necessarily represent the views of our clients or colleagues.

Proposed Amendments to the Advertising Rule

We believe that the proposed amendments to Rule 206(4)-1 under the Advisers Act (the "Advertising Rule") would provide significant additional clarity and flexibility to investment advisers by replacing the current rule's broad categorical restrictions with principles-based provisions. We agree that the tailored, principles-based approach, subject to appropriate conditions, outlined in the Proposing Release will enable investment advisers to provide investors and prospective investors with additional information that will aid them in evaluating the investment advisory services offered without increasing the risk of potential harm to investors.[2] However, we are concerned that certain aspects of the proposed amendments, in particular the proposed definition of "advertisement," which we view as overly broad, may unnecessarily restrict the ability of investment advisers to communicate with investors and would

[1] "Investment Adviser Advertisements; Compensation for Solicitations," Investment Advisers Act Release No. 5407 (Nov. 4, 2019) (the "Proposing Release"). References herein to page numbers of the Proposing Release are to the page numbers of the PDF version of the Proposing Release that is posted on the Commission's website under "Regulation, SEC Proposed Rules," available at https://www.sec.gov/rules/proposed/2019/ia-5407.pdf.

[2] Following the convention used in the Proposing Release, in this letter we refer to investment adviser advertising recipients, *i.e.*, clients and prospective clients as well as investors and prospective investors in pooled investment vehicles that the investment adviser manages, as "investors," unless otherwise specified.

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create unwarranted compliance problems for investment advisers, as well as unnecessary confusion and uncertainty for both investment advisers and investors.

In the following section of this letter, we provide comments on several particular elements of the proposed amendments to the Advertising Rule.

1. **The Proposed Definition of "Advertisement" is Overly Broad**

We are concerned that the Proposing Release defines "advertisement" so broadly that communications that should not be subject to the requirements of the proposed rule will be, or may be deemed to be, captured by the definition, including communications that the Commission did not intend to include within the scope of the Advertising Rule.

The proposed rule would define "advertisement" as "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."[3] Whereas the current definition excludes written communications addressed to only one person, the proposed definition would include any communication that meets the definition's criteria without regard to the number of people to whom the communication is addressed. The proposed rule would specifically exclude four types of communications from the definition: (i) non-broadcast live oral communications; (ii) responses to certain unsolicited requests; (iii) certain communications relating to registered investment companies ("RICs") and business development companies ("BDCs"); and (iv) information required by statute or regulation.

We request that the Commission clarify that certain communications should not be treated as advertisements subject to the rule, either by expanding the proposed specific exclusions from the definition or through explanatory commentary in the final adopting release (assuming that the amendments are eventually adopted by the Commission). As the Proposing Release notes, "if the scope of communications that is captured by the proposed rule is too broad, and captures communications not relevant for an investment adviser's advertisements, the amendments may impose costs on investment advisers while yielding insubstantial benefits."[4] We believe that the requested clarifications are all the more important in light of the proposed expansion of the Advertising Rule to expressly cover communications with existing and prospective investors in pooled investment vehicles (other than RICs and BDCs).

[3] For purposes of the proposed rule, "pooled investment vehicle" would be defined in the same way as in Rule 206(4)-8 under the Advisers Act; *i.e.*, as publicly offered investment companies and funds relying on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940 (the "Investment Company Act"). The proposed rule includes a general carve-out for communications relating to publicly offered investment companies.

[4] Proposing Release at 335.

a. Communications to Existing Investors

The proposed definition of advertisement potentially captures "any communication … that seeks to … retain one or more investment advisory clients or investors," unless the communication fits within one of the four proposed exceptions to the definition of advertisement.

Request for Clarification. We are concerned that the prong of the proposed definition pertaining to retention of existing investors might be deemed to apply to certain communications that do not clearly fit within one of the exclusions, but do not fall within the commonly understood scope of the term "advertising." In particular, we request that the Commission clarify that a communication that is provided to existing investors, where the primary goal of the communication is not to promote the investment adviser's advisory services but rather to provide relevant information about the investor's account or investment, should not be treated as an advertisement subject to the amended rule. Historically, such communications generally have not been viewed as being subject to the Advertising Rule without any evident harm resulting to investors.

Proposed Exclusion for Account Statements and Transaction Reports is Too Narrow. In keeping with a long-standing Commission staff interpretation,[5] under the proposed amendments, investment advisers could continue to deliver to existing investors account statements or transaction reports that are intended to provide only details regarding those accounts and investments without those communications being considered advertisements. The Proposing Release states: "In the usual course, a communication to an existing investor about the performance of the investor's account would not be for promoting the adviser's services or be used to obtain or retain investors. Accordingly, we would not view information typically included in an account statement, such as inflows, outflows, and account performance, as qualifying as advertisements under the proposed rule."[6] The Proposing Release also states the Commission's view that it would not view materials that provide general educational information about investing or the markets as offering or promoting an investment adviser's services or seeking to obtain or retain investors.[7] As an example, the Proposing Release notes that "an adviser that disseminates a newspaper article about the operation of investment funds or the risks of certain emerging markets would generally be circulating educational materials and not offering or promoting the adviser's own services."[8]

However, the Proposing Release also states that communications to existing investors may include information that is neither account information nor educational material, such as the investment adviser's own market commentary or a discussion of the investment adviser's investing thesis, that "may make the communication an advertisement, if that additional information 'offers or promotes' the adviser's advisory services under the facts and circumstances."[9]

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[5] *See* Investment Counsel Association of America, Inc., SEC Staff No-Action Letter (Mar. 1, 2004) (the "ICAA Letter").
[6] Proposing Release at 31-32.
[7] *Id.* at 32.
[8] *Id.*
[9] *Id.*

We understand that it is a common practice of investment advisers to provide reports to existing investors, such as monthly or quarterly investor letters, containing commentary related to an investor's account or investment that provides supplementary information to the investor intended to give the investor context and aid in understanding the information included in an account statement. Such commentary might address, for example, the investment adviser's view of the relevant market and issuers within that market and how the client's account is performing in relation to that market, and/or provide other information that helps to explain the account's performance. Certain communications may be required under the terms of the relevant investment management agreement or pooled investment vehicle's limited partnership agreement.

Potentially Chilling Effect on Communications. Investment advisers may find it difficult and confusing to determine whether particular additional information provided to aid investors in assessing an account's or a fund's performance might or might not be viewed by the Commission as falling within the proposed definition of advertisement. We are concerned that uncertainty as to whether these types of communications might be deemed to be "advertisements" could have a chilling effect on investment advisers' ability to provide useful information to investors regarding their accounts, such as reports disclosing risk information or performance attribution or letters to clients/investors explaining investment theses. The Proposing Release notes the possibility that investment advisers, under certain circumstances, may modify their communication strategies in an effort to reduce the amount of communication that could be deemed to fall within the proposed definition of advertisement and hence be subject to the rule's review and approval requirement, in turn reducing the amount of information available to potential and existing investors.[10]

We believe such a result also would be contrary to the Commission's disclosure policy position, as reflected in the management's discussion and analysis requirement for operating companies and BDCs as well as the management's discussion of fund performance (or "MDFP") requirement for open-end RICs and exchange-traded funds. We note that the Commission has proposed expanding the MDFP disclosure requirement to closed-end RICs.[11] As we discuss below, comparable disclosures by investment advisers to investors outside the RIC context would in any event be subject to the anti-fraud provisions of the Advisers Act. Such provisions should adequately protect investors without the potential chilling effect arising from treating such MDFP-type disclosures as advertisements.

Already Subject to Anti-Fraud Provisions. The Proposing Release notes that communications to existing investors may be used to mislead or deceive in the same manner as communications to prospective investors.[12] However, as the Proposing Release also acknowledges, communications that would not be "advertisements" for purposes of the proposed rule would remain subject to the anti-fraud provisions of the Advisers Act and the rules thereunder (including, in the case of fund investors, Rule 206(4)-8)) and other anti-fraud provisions of the federal securities laws, such as Section 17(a) of the Securities Act of

[10] Proposing Release at 336, 339.
[11] *See* "Securities Offering Reform for Closed-End Investment Companies," Investment Company Act Release No. 33427 (Mar. 20, 2019).
[12] Proposing Release at 33.

1933 (the "Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder, to the extent those provisions would otherwise apply.[13]

b. Responses to Unsolicited Requests

We support the exclusion from the proposed definition of "advertisement" of responses to certain unsolicited requests for information. For the sake of clarity, and to enable investment advisers to respond fully and responsibly to client and investor requests, we recommend that the Commission provide in this exclusion additional flexibility for investment advisers to provide information in addition to the "specified information" sought by the requester, when the investment adviser determines, in its own best judgment, that such information would be necessary to provide a full and responsible response to the requester.

The proposed rule would exclude from the definition of "advertisement" any communication by an investment adviser "that does no more than respond to an unsolicited request" for specified information about the investment adviser or its services, other than a communication to a Retail Person (as defined in the rule)[14] that includes performance results or a communication that includes hypothetical performance. However, the Proposing Release provides that if the investment adviser were to include additional information beyond what was specifically requested, that additional information would not qualify for the exclusion if the additional information met the definition of "advertisement."[15] The Proposing Release goes on to note that if the only additional information that the investment adviser includes is information "necessary" to make the requested specified information not misleading, the additional information would not render the communication or that additional information an advertisement.[16]

As with the issues raised with respect to information provided to existing investors, as discussed above, we believe that investment advisers may find it unnecessarily difficult and confusing – and a substantial compliance burden – to determine whether particular additional information provided to a requestor in the context of the "unsolicited request" exclusion causes the resulting communication to fall within the proposed definition of advertisement. We again are concerned that the subjective determination required, and the resulting uncertainty involved, could have a chilling effect on investment advisers' ability to provide useful information (for example, certain descriptions of performance metrics or references to specific investment advice) to investors. For example, if an investment adviser receives a specific request for the performance of a certain subset of investments it has made, the investment adviser may believe it is beneficial to provide the requestor with additional information (or the option to receive additional information) regarding the larger context in which such investments were made, such as the performance of the other investment recommendations for the accounts from which the requested subset was extracted. However, faced with the challenge of determining whether such additional information is "necessary," the investment adviser may forego providing such additional information. In our view, the investment adviser should be able to respond to an unsolicited request with additional material beyond that which

[13] *Id.* at fn. 58 and the accompanying text.
[14] The proposed rule would define clients and investors that are "qualified purchasers" or "knowledgeable employees" as "Non-Retail Persons" and all other clients and investors as "Retail Persons."
[15] Proposing Release at 47.
[16] *Id.*

was specifically requested, if: the additional material is not overtly promotional; the additional material is directly related to the request for information; and the purpose of the additional material is to clarify and add context and relevant detail, even if the investment adviser is not sure that the additional material is necessary to make the requested specified information not misleading. We note that information provided in response to an unsolicited request is still subject to the anti-fraud provisions of the Advisers Act and other federal securities laws.

2. <u>References to Specific Investment Advice</u>

The proposed rule would replace the current rule's general prohibition of past specific recommendations within an advertisement with a restriction on providing a reference to specific investment advice where such investment advice is not presented in a manner that is fair and balanced. We support replacement of the current prohibition with a principles-based restriction on the presentation of specific investment advice.

We believe that investment advisers are in the best position to determine whether specific investment advice included in an advertisement is presented in a fair and balanced manner and agree that such presentation will depend on the facts and circumstances, as well as the context, of each advertisement. Moreover, we believe that presentation of representative examples of the investment adviser's investment recommendations can clarify the investment adviser's message by providing helpful illustrations of the investment adviser's strategy, access or expertise. We agree that there may be more than one way to present favorable or profitable specific investment advice in a fair and balanced manner, and we favor an approach that allows each investment adviser to choose a presentation that fits the context of an advertisement rather than an approach that prescribes a particular presentation or inclusion of particular factors, such as a list of all recommendations made by the investment adviser in the last year. We believe that investment advisers will find the Proposing Release's examples of guidance from past Commission staff no-action letters[17] helpful in complying with the proposed rule but appreciate that the proposed rule does not require any specific factor to be followed or included in an advertisement.

Proposed Amendments to the Cash Solicitation Rule

Our comments with respect to the Commission's proposed amendments to Rule 206(4)-3 (the "Cash Solicitation Rule") focus on the proposal to expand the scope of the Cash Solicitation Rule to apply to the solicitation of prospective investors in private funds.[18]

In the Proposing Release, the Commission seeks comment on whether the Cash Solicitation Rule should be expanded to apply to the solicitation of prospective investors in private funds. Further, the Commission seeks comment on whether Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5

[17] *Id.* at 65-67.

[18] For these purposes, "private fund" is defined by reference to Section 202(a)(29) of the Advisers Act, which is an issuer that would be an investment company, as defined in the Investment Company Act, but for Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act.

thereunder already sufficiently protect prospective investors that are solicited to invest in private funds such that expanding the Cash Solicitation Rule to cover such activities is not necessary.

The Proposing Release notes that the reason for expanding the Cash Solicitation Rule to cover the solicitation of investors for private funds is to increase protections to such investors by making them aware of the solicitor's financial interest in making the referral and the related conflicts of interest.[19]

We believe that existing anti-fraud provisions already require that investment advisers and solicitors provide disclosures to prospective investors regarding the conflicts of interest relating to solicitation arrangements. In our view, it therefore is unnecessary for the Commission to expand the scope of the Cash Solicitation Rule to apply to the solicitation of prospective investors in private funds.

As the Proposing Release states, the amendments would not apply to the solicitation of existing and prospective investors in RICs and BDCs, because the policy goals of the Cash Solicitation Rule, in particular the disclosure of the conflicts of interest, are satisfied by other regulatory requirements applicable to RICs and BDCs. The Proposing Release notes that because RICs and BDCs are sold through broker-dealers and other financial intermediaries, prospective investors already receive disclosures relating to the conflicts of interest that arise as a result of the solicitation arrangements. For example, FINRA Rule 2341(1)(4) specifically prohibits a broker-dealer from accepting any cash compensation from an investment adviser, among others, for referrals to a RIC or BDC unless the compensation is described in the fund's prospectus.[20]

The Proposing Release sets out the Commission's view that the existing regulations applicable to the solicitation of investors in private funds do not require conflict of interest disclosure comparable to the disclosure requirements applicable to the solicitation of investors in RICs and BDCs. We respectfully disagree.

Advisers Act Rule 206(4)-8, already applicable to the solicitation of investors in private funds, states: "It shall constitute a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of section 206(4) of the Advisers Act for any investment adviser to a pooled investment vehicle to: (1) Make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or (2) Otherwise engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle." Accordingly, pursuant to Section 206(4) and Rule 206(4)-8, an investment adviser already has an obligation to disclose material facts and conflicts of interest. In our experience, investment advisers may use a variety of means to disclose the conflicts of interest, including in a fund's offering memorandum.

Solicitors, as registered broker-dealers, have an existing, independent obligation to disclose the material conflicts of interest associated with the solicitation arrangement. In addition to being subject (as are the

[19] Proposing Release at 210.
[20] *Id.* at 210-211, fn. 364.

issuer parties) to the anti-fraud provisions of the Exchange Act in connection with the solicitation of any private fund investors, broker-dealers must comply with Rule 15*l*-1 under the Exchange Act (commonly referred to as "Regulation Best Interest") when potential investors include "retail customers."[21] Regulation Best Interest requires a broker-dealer and its associated persons to, among other things, disclose to retail customers all material facts relating to conflicts of interest that are associated with their recommendations to purchase a security (which would include interests in private funds), including any compensation the broker-dealer will receive relating to such recommendations.

For the reasons discussed above, we recommend that the Commission not expand the scope of the Cash Solicitation Rule to cover the solicitation of private fund investors.

Application of the Advertising Rule and the Cash Solicitation Rule to Non-U.S. Investment Advisers

In accordance with the Commission's "conduct and effects" standard and under existing Commission staff guidance, while a registered investment adviser whose principal office and place of business is outside of the United States (a "non-U.S. investment adviser") is subject to a limited number of Advisers Act requirements with respect to its non-U.S. clients, many of the specific rules under the Advisers Act do not apply. Specifically, the Commission has stated that the Advertising Rule and the Cash Solicitation Rule do not apply to a non-U.S. investment adviser's dealings with its non-U.S. clients.[22] The Commission further has indicated that a non-U.S. investment adviser to a private fund organized and managed outside the United States (a "non-U.S. fund") may treat such non-U.S. fund as a non-U.S. client for Advisers Act purposes, even if the fund has U.S. resident investors.[23]

We request that the Commission clarify that if the amendments to the Advertising Rule and/or the Cash Solicitation Rule are adopted (if and as revised), the Advertising Rule and/or (as pertinent) the Cash Solicitation Rule will continue to not be applied to a non-U.S. investment adviser's dealings with its non-U.S. clients, even if the non-U.S. client is a non-U.S. private fund with U.S. investors. We note that a non-U.S. investment adviser would remain subject to the anti-fraud provisions of the Advisers Act in its dealings with its non-U.S. clients, including non-U.S. funds with U.S. investors.

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We thank you for the opportunity to submit this comment letter.

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[21] As used in Regulation Best Interest, "retail customer" means a natural person, or the legal representative of such natural person, who: (i) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (ii) Uses the recommendation primarily for personal, family, or household purposes.

[22] *See* "Registration Under the Advisers Act of Certain Hedge Fund Advisers," Investment Advisers Act Release No. 2333 (Dec. 2, 2004).

[23] *Id.*

If you would like to discuss these comments, please do not hesitate to contact Laurin Blumenthal Kleiman at 212-839-5525, W. Hardy Callcott at 415-772-7402, David A. Form at 212-839-7329 or Jonathan B. Miller at 212-839-5385.

Very truly yours,

Sidley Austin LLP

Sidley Austin LLP