FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

February 12, 2020

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

Re: Investment Adviser Advertisements; Compensation for Solicitations, Investment Advisers Act Release No. 5407; File Number S7-21-19

Dear Ms. Countryman:

The Financial Services Institute[1] appreciates the opportunity to provide our comments to the Securities and Exchange Commission ("SEC" or "Commission") on the proposed changes to the rules governing investment adviser advertisements and solicitation in Advisers Act Release No. 5407 (Nov. 4, 2019) (the "Proposing Release" or the "Proposal").[2]

FSI shares the Commission's point of view that modernizing both the advertisement and solicitation rules is a worthwhile endeavor. FSI's core mission is to ensure that all individuals, regardless of their level of wealth, have access to competent and affordable financial advice, products, and services; furthermore, the majority of FSI member firms provide investment advice through registered investment advisers and their investment adviser representatives. Effective and streamlined rules for advertising and solicitation promote both investor protection and clarity for our member firms.

In our comments we note areas where we believe the proposal could be improved. The areas our letter focuses on include: the definitions of both advertising and solicitation, additional comments on streamlining the advertising review process, areas where the SEC could draw from FINRA's approach and ensure greater harmonization, and our comments on the overly expanded disqualification provisions in the proposed solicitation rule. We provide these discrete comments on several issues to assist the Commission in its rulemaking process and appreciate the opportunity to provide the input on behalf of our members.

[1] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[2] Investment Adviser Advertisements; Compensation for Solicitations, 84 Fed. Reg. 67518 (Dec. 10, 2019), available at https://www.sec.gov/rules/proposed/2019/ia-5407.pdf.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives.[3] These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD). [4]

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity.[5] This activity, in turn, supports 482,100 jobs, including direct employees, those employed in the supply chain, and those supported in the broader economy.[6]

Discussion

As stated above, FSI shares the Commission's point of view that modernizing both the advertisement and solicitation rules is a worthwhile endeavor. Effective and streamlined rules for advertising and solicitation promote both investor protection and clarity for our member firms. Our comments focus on the definitions of both advertising and solicitation, suggestions for streamlining the advertising review process, and suggested areas where the SEC could draw from FINRA's approach and ensure greater harmonization. Additionally, we comment on what we are concerned may be overly expanded disqualification provisions in the proposed solicitation rule.

I. Proposed Amendments to the Advertising Rule

A. Introduction

Within the proposed rule we are concerned with changes to the advertising rule's expansion in scope and requirements as well as the number of different individuals, entities and

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[3] Cerulli Associates, Advisor Headcount 2016, on file with author.
[4] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a dually registered representative of a broker-dealer and an investment adviser representative of a registered investment adviser firm. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.
[5] Oxford Economics, The Economic Impact of FSI's Members at p. 23 (July 2016), https://financialservices.org/wp-content/uploads/2017/03/FSI-Impact-Report-Final.pdf.
[6] *Id.*

intermediaries to whom the rule applies. We offer below comments with regard to certain discrete areas of the rule, including scope.

B. FSI Recommends That the SEC Narrow the Definition of "Advertisement" to Avoid Creating Unnecessary Regulatory Burden

FSI notes that the proposed rule defines an "advertisement" broadly to mean "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." FSI believes that this definition is overbroad and respectfully requests that the Commission narrow the scope of the proposed definition in a number of respects.

First, we recommend that the proposed rule not cover communications by intermediaries of the investment adviser. As drafted, the proposed rule includes all communications "by or on behalf of" the investment adviser, which would include all communications disseminated by any third party to the adviser. We believe that the proposed rule should be clarified to state that it does not cover communications by anyone that is not under the control of the adviser.

Second, we also request that the definition not extend to the communications by employees in their personal capacity (e.g. social media posts). The proposed definition is sufficiently broad that it raises the question as to whether it would apply in such situations. If so, we believe this would place an unreasonable regulatory burden on the adviser.

Third, we believe that the definition should exclude communications aimed at retaining clients or investors. We respectfully submit that essentially all communications to an existing client or investor are designed, in some manner, to retain that client or investor's patronage. We believe this cannot be the intention of the Proposal and ask that the Commission remove the "retain" factor from the definition.

Fourth, we recommend that the definition exclude any communications, shared by the adviser, that do not offer advisory services. Advisers regularly publicize additional content about the firm's business, culture, social activism and responsibility, and other factors important to clients and potential investors. Under the proposed definition, and based on the Commission's requirements, this type of content includes materials that do not explicitly "offer" investment advisory services or participation in a pooled investment vehicle.[7] We note the importance of ensuring that this type of content not fall within the proposed definition of advertisement.

Lastly, we believe that expanding the definition to cover investors in pooled investment vehicles is an unnecessary regulatory burden. Communications to such investors by broker-dealers are already regulated under FINRA Rule 2210. The Commission's extension of the Advertising Rule to such investors will only serve to create duplicative requirements and increase regulatory costs for the adviser.

[7] Proposing Release at 67522-23.

C. FSI Recommends That Individualized Communication be Excluded from the Definition of "Advertisement"

FSI respectfully submits that individualized communications be excluded from the definition of "advertisement." The proposed definition moves from a "more than one" standard to a "one or more" standard. Under the "one or more" standard, there is a serious risk that all communications between an adviser and a single potential client or investor would be considered an advertisement. We therefore request that the Commission retain the present "more than one" standard or include an exception for communications between an adviser and a single investment advisory client or investor.

We also believe that the Commission should exclude customized communications to specific clients or investors. Our members regularly create documents designed to address particular concerns raised by the client or potential investor, such as responses to requests for proposal and requests for information. Bringing these types of communications within the definition of "advertisement" is unnecessary and will only serve to obstruct the service being provided to the client or potential investor.

Finally, we request that the Commission explicitly recognize that investment advisers often interact with people who represent "one" client, such as members of an investment committee or a group of trustees representing a corporation, pension plan, or trust. In these instances, the adviser is interacting with a single client or potential investor: the committee, corporation, pension plan, or trust. Similarly, an adviser may represent multiple accounts for one client, together comprising a single relationship. We believe any such communications to either a single entity client or potential investor, or accounts comprising a single relationship, should fall within the one-on-one communication exception we outlined above.

D. FSI Recommends That the Proposed Rule be Aligned with FINRA's Advertising Review and Approval Regime

FSI notes that the proposed rule differs substantially from FINRA's regime with respect to the review and approval of advertisements. The proposed rule will require all advertisements to be reviewed and approved by a designated employee prior to distribution, with a limited number of exceptions to the prior review requirement. The FINRA regime, in contrast, permits a more refined approach to the review and approval of communications that differentiates the review requirements based on type of communication (e.g., correspondence, retail communications, and institutional communications). Further, the FINRA approach recognizes pragmatic considerations that make prior approval challenging in certain circumstances, such as public appearances.

We note that these inconsistencies between the proposed rule and FINRA's advertising review regime effectively create dual regimes that result in regulatory hurdles for dual-registered firms. We also note that several of our members have indicated that the same team (or department) at their firms review both broker-dealer and investment adviser advertising; more consistency between the SEC and FINRA requirements for review and approval of advertising will therefore allow for greater efficiency for our members.

We respectfully submit that there would be increased efficiency and less regulatory burden if the commission were to further align with FINRA's regime with respect to the review

and approval of advertisements. By proceeding with the proposed rule, the Commission runs the risk of creating regulatory confusion by having compliance officers apply separate regimes to the same documents.

II. Proposed Amendments to the Solicitation Rule

A. Introduction

As noted above, FSI supports the SEC's work to modernize both the advertising and solicitation rules. Within the proposed rule we are concerned with changes to the solicitation rule's expansion in scope and requirements. We offer below comments with regard to certain discrete areas of the rule, including scope, the expansion to address all forms of compensation, and the disqualifications for persons engaged in misconduct. As an overarching comment, we request the Commission harmonize the proposed solicitation rule regime as much as possible with existing regimes, whether FINRA for non-cash compensation, or Regulation D Rule 506 for statutory disqualification.

B. FSI Recommends the SEC Focuses the Scope of the Rule on Intentional Solicitation Activity, Further Differentiate Solicitation Activity from Advertising Activity, and Return to its Position that Solicitors Remain Exempt from Advisers Act Registration

FSI recommends the Commission narrow the current interpretation of the scope of the proposed rule. FSI notes that the definition of a solicitor under the proposed rule is -- other than the inclusion of private fund investors -- fairly consistent with the existing rule, but that the Commission takes an expansive interpretation to who is a solicitor. For example, promoters who receive compensation for testimonials or endorsements could be subject to the proposed rule. The Proposing Release also addresses solicitor registration requirements by reversing its position that solicitors are associated persons of investment advisers and therefore are not required to register under the Advisers Act as a result of their solicitation activities.

FSI's members rely on a variety of solicitation and referral arrangements and believes that the definition of a solicitor should focus on intentional solicitation activity, whereby solicitation activities are directed at specific clients or investors in return for compensation for successful referrals. We are generally concerned about circumstances that may qualify as referrals under the Proposal's expansive reach, particularly in instances where information is provided but no immediate referral or compensation occurs. We recommend that the Commission take a more precise approach to regulating intentional solicitation activity, as opposed to the expansive approach in the Proposal. FSI also recommends that the SEC further differentiate between advertising and solicitation activities, as FSI generally takes the position that overlapping rules for the same activity is duplicative and overly burdensome.

FSI notes that as part of the discussion on the scope of solicitation, the Proposing Release highlights a significant policy change that would reverse its long-standing position exempting solicitors from investment adviser registration. We recommend that the SEC maintain this position rather than reverse it by concluding that "depending on the facts and circumstances, a person providing advice as to the selection or retention of an investment adviser may be an 'investment adviser' within the meaning of Section 202(a)(11) of the Act and may also have an obligation to register under the Act."[8] We are concerned about additional obligations on solicitors to evaluate

[8] See Proposing Release, 67571 n.346.

whether they would need to register as an investment adviser or would otherwise be subject to an exemption from registration under both federal and state law, as opposed to relying on the presumption they are associated persons and will not be required to register as an investment adviser with the SEC.[9] Furthermore, as the adviser continues to have a reasonable-basis obligation over the solicitation activities pursuant to the proposed rule, the solicitor should continue to have an exemption from investment adviser registration.

C. FSI Recommends the Commission Narrow Its Non-Cash Compensation and Provide Greater Clarity Between Direct and Indirect Compensation

FSI recognizes the holistic approach the Commission has taken to cash and non-cash compensation but recommends that the Commission provide further clarity and guidance that more clearly distinguishes between direct and indirect compensation. We are particularly concerned about any chilling effects on solicitation arrangements our members have as a result of lack of clarity, particularly with regard to non-cash indirect compensation. With regard to timing of compensation, we recommend the Commission consider applying the proposed rule to compensation occurring after the solicitation, unless the adviser-solicitor agreement specifically includes compensation prior to the solicitation activities. Without narrowing the proposed rule's elements regarding compensation, our members may have to discontinue certain solicitation arrangements, such as informal arrangements between lawyers and advisers that ultimately benefit investors by providing them with additional resources to manage their finances.

As noted above, FSI generally recommends harmonization between different, but related rule regimes, insofar as that is possible. To this end, FSI recommends the Commission apply additional non-cash exemptions to align with FINRA's proposed approach to non-cash compensation. Specifically, we note that in 2016, FINRA released a proposed amendment to its gifts, gratuities, and non-cash compensation rules. The FINRA proposal also includes as exceptions to non-cash compensation: (i) training or education meetings; and (ii) internal sales contests. With respect to training or education meetings, we note there is no express exemption in the proposed rule, though the Commission discusses that such meetings may not be considered compensation. The omission from the proposed rule has the potential to create confusion, and we recommend that the Commission create an express exemption for training or education meetings.

With respect to internal sales contests, the Commission states that, under the proposed rule, "sales awards or other prizes" would be considered non-cash compensation. We note that dual registrants are in the midst of Regulation Best Interest implementation, which includes re-examining sales contests, and that FINRA has an exception from non-cash compensation for sales contests. Therefore, we are concerned that the proposed rule conflicts with the FINRA approach, which would especially impact our dual registrant members. We respectfully request that the Commission consider adding an internal sales contest exemption to align with the exemption FINRA is currently considering. In addition to requesting alignment with the non-cash compensation approach FINRA is considering, we also encourage coordination between the Commission and FINRA to ensure alignment between related aspects of this rule.

[9] See Requirements Governing Payments of Cash Referral Fees by Investment Advisers, 44 FR 42126, at 42129 (Jul. 18, 1979) (the "1979 Adopting Release")("a solicitor who engages in solicitation activities in accordance with paragraph (a)(2)(iii) of the rule . . . . will be, at least with respect to those activities, an associated person of an investment adviser and therefore will not be required to register individually under the Advisers Act solely as a result of those activities.").

D. The SEC Should Harmonize the De Minimis Exemption with FINRA's Approach

We support the SEC's consideration of various exemptions as part of the proposed rule, and offer comments with regard to the *de minimis* exemption. We note the Proposing Release acknowledgment that it would be overly burdensome for advisers and solicitors that engage in solicitation for de minimis compensation to comply with the rule. The proposed rule therefore includes a threshold of $100 or less (or the equivalent value in non-cash compensation) paid over the preceding 12 months. We note that as part of FINRA's Regulatory Notice 16-29, FINRA proposed raising its $100 threshold for FINRA Rule 3220 (Influencing or Rewarding Employees of Others) ("FINRA Gifts Rule") to $175. We also note that FINRA's Retrospective Rule Review Report for Gifts, Gratuities and Non-Cash Compensation suggested $250 would be a reasonable threshold. As with our discussion on non-cash compensation above, we recommend the Commission coordinate with FINRA regarding the de minimis amount.

E. FSI Recommends the SEC Align the Proposed Rule's Statutory Disqualification Framework to Regulation D Rule 506

We note that the proposed rule includes a significant update to the disqualification provisions of the current rule, through the introduction of the concept of an Ineligible Solicitor. An Ineligible Solicitor is defined as a person who, at the time of the solicitation, is either subject to a "Disqualifying Commission Action" or is subject to any "Disqualifying Event." The reasonable care standard will require advisers to make inquiries into the solicitor in order to comply with the proposed rule's obligations. We appreciate that the Commission has chosen, based on precedent and practice with other Commission rules, not to prescribe the level, method, or frequency of due diligence. However, we recommend the SEC revise the scope of the disqualification provision so that it is consistent with Regulation D, Rule 506. This will contribute to more efficient compliance processes at firms and decrease confusion with respect to competing definitions regarding what constitutes a disqualifying action or event.

With regard to rule implementation, we respectfully request that the Commission include a grandfathering provision for advisers with contractual solicitation arrangements that have been entered into based on the current rule. We also request a similar grandfathering provision for advisers that received no-action letters from Commission staff stating that the staff would not recommend enforcement action to the Commission under section 206(4) and rule 206(4)-3 if an adviser paid cash solicitation fees to a solicitor that was subject to particular disciplinary events that fall within the current rule's disqualification provision. Both grandfathering provisions would alleviate disruption to existing arrangements. We note that advisers and solicitors have relied on either existing law and rules or on existing no-action letters to build networks and relationships. We also request that the Commission delay implementation of the expanded requirements of the disqualification provision to give advisers sufficient time to adopt the necessary policies and procedures.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the SEC on this and other important regulatory efforts

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 393-0022.

Respectfully submitted,

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