EFAMA

European Fund and Asset Management Association

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

Brussels, 13 February 2020

Ref. 20-1009

Dear Ms. Countryman:

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

On November 4, 2019, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") proposed amendments to modernize the rules under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act") to address investment adviser advertisements and payments to solicitors (the "Amendments").[1] The European Fund and Asset Management Association ("EFAMA") respectfully submits this letter in response to a request by the Commission for comments on the Amendments regarding the Commission's proposal to revise Rule 206(4)-3 promulgated under the Advisers Act (the "Solicitation Rule") to, in part, replace the Solicitation Rule's broadly drawn limitations on payments to solicitors with more principles-based provisions (the "Proposal").

EFAMA is the voice of the European investment management industry, representing twenty-eight member associations, fifty-nine corporate members and twenty-two associate members. At the end of the third quarter of 2019, the European asset management industry had total net assets of EUR 17.2 trillion, comprising almost 62,500 investment funds of which almost 34,000 were Undertakings for Collective Investments in Transferable Securities ("UCITS") funds[2] and almost 28,500 were European Alternative Investment Funds (each, an "AIF" and collectively, "AIFs").[3]

PROPOSED AMENDMENTS TO SOLICITATION RULE

The Solicitation Rule currently prohibits any investment adviser required to be registered pursuant to Section 203 of the Advisers Act (each, an "Adviser") from paying a cash fee, directly or indirectly, to a "solicitor" with respect to solicitation activities,[4] unless certain conditions are met.[5] The Solicitation Rule was designed to

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1 *Investment Adviser Advertisements; Compensation for Solicitation*, SEC Release No. IA-5407, 84 Fed. Reg. 67518 (Nov. 4, 2019), available at https://www.federalregister.gov/documents/2019/12/10/2019-24651/investment-adviser-advertisements-compensation-for-solicitations (the "Proposing Release").

2 UCITS are retail, regulated open-end investment funds that comply with the UCITS Directive, as implemented under EU national law. *See* Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

3 For these purposes, an AIF is any fund other than a fund authorized as a UCITS that complies with the Alternative Investment Fund Managers Directive (AIFMD), as implemented under EU national law. *See* Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010.

4 *See* Proposing Release at 202, 480 ("*Solicitor* means any person who, directly or indirectly, solicits any client or private fund investor for, or refers any client or private fund investor to, an investment adviser.").

5 *See* 17 C.F.R. § 275.206(4)-3 (2019); *see also* Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Advisers Act Release No. 615 (Feb. 2, 1978) ("1978 Proposing Release"); Requirements Governing Payments of Cash Referral Fees by Investment Advisers, Advisers Act Release No. 688 (July 12, 1979).

address, "inherent conflicts of interest which can be present in arrangements pursuant to which an individual receives compensation, even on a fully disclosed basis, for referring someone to an [A]dviser. . ."[6]

The Solicitation Rule has historically only applied to an Adviser's payments to a solicitor with respect to solicitation activities for "clients" and not with respect to solicitation activities for investors in an investment pool managed by the Adviser (*i.e.*, a private fund).[7] The Proposal would extend the scope of the Solicitation Rule to the solicitation of existing and prospective private fund investors (and not just the Adviser's clients) in an effort to increase the protections afforded to such investors by making them aware of the solicitor's financial interest in the investor's investment in a private fund and prohibiting the use of "disqualified solicitors."[8]

The Commission has requested comment on whether the Proposal should apply to the solicitation of some or all investors in pooled investment vehicles, including whether the Proposal should apply to the solicitation of investors in private funds.[9] We support the Commission's proposal to increase protections to investors in collective investment schemes. We are, however, concerned that the Proposal may inadvertently require Advisers to UCITS and AIFs, which are already subject to regulation in a foreign jurisdiction, to comply with the Solicitation Rule as a result of fees that may be paid out of the Adviser's management fee for distribution.

To the extent that the Commission does enact the current Proposal and apply the Solicitation Rule to the solicitation of investors in a "private fund," we would request that the Commission amend the definition of "private fund" in the Proposed Rule to: (i) exclude non-U.S. domiciled publicly offered, closed-end and open-end investment funds, including UCITS (the "Non-U.S. Publicly Offered Funds"); and (ii) further exclude AIFs and other non-U.S. domiciled funds that would be an investment company, as defined in Section 3 of the U.S. Investment Company Act of 1940, as amended ("Investment Company Act") but for Sections 3(c)(1) or 3(c)(7) of the Investment Company Act.

The Commission should not require an Adviser to a Non-U.S. Publicly Offered Fund to comply with the Solicitation Rule simply because it may have a small amount of U.S. capital invested in such fund (*e.g.*, as a result of seed capital invested from the Adviser). In such case, the Proposal would impose requirements in addition to, and potentially conflicting with, the relevant EU regulatory regimes already in place to govern such fund products and distribution arrangements.[10] It should be noted that the principles of international comity would dictate that in cases where the U.S. jurisdictional interest is not as great as that of another jurisdiction it would be appropriate to defer to that foreign jurisdiction to enforce and protect the rights of its own citizens or of other persons who are under the protection of its laws.[11]

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6 1978 Proposing Release.

7 *See Mayer Brown LLP*, SEC Staff No-Action Letter (pub. avail. July 28, 2008).

8 *See* Proposing Release at 210. A disqualified or "ineligible solicitor" is defined as: "(A) [a] person who at the time of the solicitation is subject to a disqualifying Commission action or is subject to any disqualifying event; (B) [a]ny employee, officer or director of an ineligible solicitor and any other individuals with similar status or functions; (C) [i]f the ineligible solicitor is a partnership, all general partners; (D) [i]f the ineligible solicitor is a limited liability company managed by elected managers, all elected managers; and (E) [a]ny person directly or indirectly controlling or controlled by the ineligible solicitor as well as" certain other persons specified in the Proposal. *See id.* at 476-77.

9 *See id.* at 211.

10 For example, the European Union's recast Markets in Financial Instruments Directive ("MiFID II") requires that certain information regarding distribution arrangements and related fees be provided to investors in a Non-U.S. Publicly Offered Fund or an AIF that is distributed through a regulated MiFID investment firm (*e.g.*, a regulated EU distributor or solicitor). *See* MiFID II, Art. 24(4) ("Appropriate information shall be provided in good time to clients or potential clients with regard to the investment firm and its services, the financial instruments and proposed investment strategies, execution venues and all costs and related charges."); MiFID II, 24(4)(a)(i)-(ii), 24(7) (distinguishing advice provided on an "independent" and "non-independent" basis and associated disclosure obligations).

11 When considering the jurisdictional reach of the U.S. securities laws, the U.S. courts have looked to balance their interest in remedying harms having a substantial effect on investors within the United States, even if those harms had been perpetrated abroad, with the principles of international comity. The Advisers Act specifies that U.S. courts shall have jurisdiction over certain actions alleging a violation of the anti-fraud provisions under Section 206 of the Advisers Act that involve conduct "that has a foreseeable substantial effect within the United States." 15 U.S.C. 80b-14(b) (2018). With little Congressional guidance concerning the scope of the antifraud provisions of the U.S. federal securities laws, U.S. courts have historically applied two general tests, the "conduct test" and the "effects test," in prescribing the limits of U.S. jurisdiction over transnational securities transactions. *See Sec. & Exch. Comm'n v. Scoville*, 913 F.3d 1204 (10th Cir. 2019); *Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247 (2010); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974, 993 (2d Cir.

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As a practical matter, the Commission also would find it difficult to police such a large potential universe of funds, and we would suggest that the Commission should rely on the good offices of foreign regulators to enforce their own laws in such cases, including with respect to conflicts of interests. Excluding Non-U.S. Publicly Offered Funds (*e.g.*, UCITS) from the definition of "private fund" would be consistent with the Commission proposal to exclude U.S. registered mutual funds ("RICs") and business development companies ("BDCs") where the primary goal of the Solicitation Rule is already satisfied by other regulatory requirements.[12]

We also urge the Commission to exclude any other non-U.S. investment fund that is not otherwise relying on an exemption from registration under the Investment Company Act under Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, including AIFs. The Commission should, in our view, defer to the regulators of those foreign issuers to protect the interests of investors, most of whom would not be U.S. investors.

APPLICATION OF SOLICITOR DISCLOSURE TO NON-U.S. INVESTORS

The Solicitation Rule would prohibit an Adviser from compensating solicitors unless the Adviser and the Solicitor have, in a written agreement, designated the solicitor or Adviser to provide to investors at the time of any solicitation activities (or in the case of mass communication, as soon as practicably thereafter), a separate disclosure containing certain specified information.[13] In light of the burdens and costs that would be imposed on Advisers to Non-U.S. Publicly Offered Funds as a result of the Proposal and the potential conflict of interest with European law governing conflict of interest disclosure by distributors and solicitors of Non-U.S. Publicly Offered Funds and AIFs with respect to non-U.S. investors, we urge the Commission to limit the disclosure obligations of the Proposal to "U.S. Person" investors in a private fund, as such term is defined in Regulation S promulgated under the U.S. Securities Act of 1933, as amended (the "Securities Act").[14]

The Commission has previously stated that, under certain circumstances, a foreign investment company not registered under the Investment Company Act could make a "private offering" in the U.S., coincident with a public offering of that fund's shares abroad, without violating Section 7(d) of the Investment Company Act.[15] Following longstanding Commission and guidance from the Commission staff (the "Staff"), a foreign fund that is conducting a public offshore offering also may make, under certain circumstances, a private U.S. offering in reliance on Section 3(c)(1)[16] or Section 3(c)(7)[17] of the Investment Company Act and Rule 506 of Regulation

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1975), *cert. denied*, 423 U.S. 1018 (1975); *see also Leasco Data Processing Equip. Corp. v. Kerman*, 468 F.2d 1326 (2d Cir. 1972); *IIT v. Vencap, Ltd.*, 519 F.2d 1001 (2d Cir. 1975). This is also consistent with the Commission's conduct and effects test for determining whether the Advisers Act applies to the activities of a domestic or foreign Adviser. *See, e.g.*, U.S. Sec. & Exch. Comm'n, Protecting Investors: A Half Century of Investment Company Regulation 221-236 (1992) (the "Report").

12 *See* Proposing Release at 210. The Proposal defines a "private fund" pursuant to Section 2(a)(29) of the Investment Company Act as "an issuer that would be an investment company, as defined in section 3 of the [Investment Company Act], but for section 3(c)(1) or 3(c)(7) of that Act." *Id.* at 480; 15 U.S.C. 80b-2(a)(29) (2018). The Proposal specifies that the Solicitation Rule would not apply to RICs and BDCs. *See id.* (noting that "[u]nlike for private funds, the primary goal of the proposed solicitation rule is already satisfied by other regulatory requirements applicable to RICs and BDCs: prospective investors in RICs and BDCs sold through a broker-dealer or other financial intermediary already receive disclosure about the conflicts of interest that may be created as a result of the fund or its related companies paying the intermediary for the sale of its shares and related services").

13 *See* Proposing Release at 212 (requiring that any solicitation disclosure state: (i) the name of the Adviser; (ii) the name of the solicitor; (iii) a description of the Adviser's relationship with the solicitor; (iv) the terms of any compensation arrangement; and (v) any potential material conflicts of interest on the part of the solicitor resulting from the Adviser's relationship with the solicitor and/or the compensation arrangement).

14 *See supra* note 10 (MiFID point of sale disclosure with respect to European resident investors).

15 *See Goodwin Procter & Hoar*, SEC No-Action Letter (pub. avail Feb. 28, 1997) ("Goodwin Procter Letter"); *see also Touche, Remnant & Co.*, SEC No-Action Letter (pub. avail. Aug. 27, 1984) ("Touche Remnant Letter").

16 *See* Touche Remnant Letter, *supra* note 15 (applying Section 3(c)(1) along with Section 7(d) of the Investment Company Act with the result that non-U.S. investment funds may have up to one hundred U.S. beneficial owners).

17 *See* Goodwin Procter Letter, *supra* note 15 (following the Touche Remnant Letter, the Commission has confirmed that an offshore (non-U.S.) fund may rely on the Section 3(c)(7) exception and that it may have non-U.S. participants who are not qualified purchasers); *see also Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, International Series Release No. 1125 (pub. avail. Mar. 23, 1998) (endorsing the Staff's positions in the Goodwin Procter Letter and Touche Remnant Letter).

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D promulgated under the Securities Act, consistent with the U.S. public offering prohibition in Section 7(d) of the Investment Company Act. As noted above, these foreign funds are currently subject to regulation in a foreign jurisdiction, and non-U.S. investors in such funds would have no reason to expect the full protection of the U.S. federal securities laws.

To the extent that the Commission applies the compliance and disclosure obligations of the Solicitation Rule to distribution arrangements of Non-U.S. Publicly Offered Funds and AIFs with respect to non-U.S. person investors, an uneven playing field with respect to distribution of such products by non-U.S. advisers (which would not be subject to the Solicitation Rule) would be created.[18] In addition, the compliance and disclosure obligations of the Solicitation Rule would conflict with current conflict of interest disclosures required under European law. As a result, we urge the Commission to only apply the compliance and disclosure obligations of the Solicitation Rule with respect to U.S. person investors.

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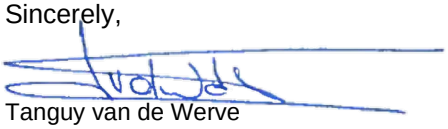
Again, we appreciate the opportunity to comment. If we can answer any questions or be of further assistance, please contact Christopher D. Christian, a partner at Dechert LLP, at (617) 728-7173.

Sincerely,



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[18] The recommendations contained herein are consistent with the Commission's conduct and effects test for determining whether the Advisers Act applies to the activities of a domestic or foreign Adviser. *See, e.g.*, the Report, *supra* note 11, at 221-236 (stating that, under the Commission's conduct and effects test, the Advisers Act "would apply to activities where a sizable amount of advisory services takes place *in the United States* or where the advisory services have effects *in the United States*").

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