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February 19, 2020

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

Re: Request for Comment on Proposed Amendments to Rule 206(4)-1 and Rule 206(4)-3 under the Investment Advisers Act of 1940 (the "Advisers Act"); File No. S7-21-19

Dear Ms. Countryman:

We submit this letter in response to the request by the U.S. Securities and Exchange Commission (the "Commission") for comments on the proposed rule amendments set forth in Release No. IA-5407 (the "Release").[1] In the Release, the Commission proposes amendments to Rule 206(4)-1, which prohibits certain advertising practices by registered investment advisers, and Rule 206(4)-3,[2] which imposes certain disclosure and related requirements on registered investment advisers that compensate solicitors. The amendments to Rule 206(4)-1 are intended to update this rule to reflect changes in technology, the expectations of investors seeking advisory services, and the evolution of industry practice since the adoption of the rule in 1961.[3] The proposed amendments would, among other things, include tailored requirements for the presentation of performance results in an advertisement based on an advertisement's intended audience,[4] and require an investment adviser to designate an employee to review each advertisement for consistency with the requirements of Rule 206(4)-1 and approve the advertisement before its use by the adviser.[5]

We appreciate the opportunity to comment on aspects of the proposed amendments to Rule 206(4)-1. Seward & Kissel LLP has a substantial number of clients who would be affected by the adoption of the proposed amendments. We respectfully submit the following comments and request that the Commission consider them before adopting the proposed amendments. We note that the views expressed in this letter are our own views and do not necessarily reflect those of our clients.

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[1] Investment Adviser Advertisements; Compensation for Solicitations, Advisers Act Release No. IA-5407, 84 FR 67518 (proposed Dec. 10, 2019) (to be codified at 17 C.F.R. Pts. 275 and 279) ("Release").
[2] We are not submitting comments on the proposed amendments to Rule 206(4)-3.
[3] Press Release, SEC Proposes to Modernize the Advertising and Cash Solicitation Rules for Investment Advisers (Nov. 4, 2019) *available at* https://www.sec.gov/news/press-release/2019-230.
[4] *See* proposed rule 206(4)-1(c).
[5] *See* proposed rule 206(4)-1(d).

I. Definition of Non-Retail Person

If adopted, the proposed amendments would impose different standards for advertisements containing performance information, which standards would depend on whether the recipient of the advertisement is a "retail person" or a "non-retail person."[6] A retail advertisement would be subject to additional requirements, including presenting net performance information with any gross performance information. The proposed amendments would define a "retail advertisement" as any advertisement other than a "non-retail advertisement" and a retail person as any person other than a non-retail person.[7]

Under the proposed amendments, a non-retail person, who may receive a non-retail advertisement,[8] would mean any person who is: (i) a "qualified purchaser," as defined in Section 2(a)(51) of the Investment Company Act of 1940, as amended (the "1940 Act");[9] or (ii) certain "knowledgeable employees," as defined in Rule 3c-5 under the 1940 Act ("Rule 3c-5").[10] We believe that there are other categories of advisory clients and investors (classified under existing standards in the Federal securities laws) that should be treated as non-retail persons. We are suggesting these changes because we believe that the additional conditions imposed on the presentation of performance results in retail advertisements are unnecessary with respect to these additional categories of clients and investors. Specifically, we believe that such persons have sufficient access to analytical and other resources to assess: (i) gross performance information without the benefit of seeing net performance displayed with equal prominence and calculated over the same time period using the same type of return and methodology;[11] and (ii) performance results of a portfolio or composite aggregation of related portfolios shown over time periods other than the proscribed one-, five-, and ten-year time periods presented with equal prominence.[12]

We believe that the definition of a non-retail person should include a person who is: (i) not a "U.S. person" as defined in Rule 902(k) of Regulation S under the Securities Act of 1933, as amended (the "Securities Act"); (ii) a "qualified client" as defined in Rule 205-3 under the Advisers Act ("Rule 205-3"); or (iii) an "accredited investor," as defined in Rule 501(a) of Regulation D under the Securities Act. Additionally, we believe the Commission should clarify

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[6] *See* proposed rule 206(4)-1(c).
[7] *See* proposed rule 206(4)-1(e)(13) (defining "retail advertisement"); proposed rule 206(4)-1(e)(14) (defining "retail person").
[8] Defined as any advertisement for which an investment adviser has adopted and implemented policies and procedures reasonably designed to ensure that the advertisement is disseminated solely to non-retail persons. *See* proposed rule 206(4)-1(e)(7).
[9] *See* proposed rule 206(4)-1(e)(7); proposed rule 206(4)-1(e)(8).
[10] Proposed rule 206(4)-1(e)(8)(ii). It appears that under the proposed amendments, a knowledgeable employee will only be a non-retail person with respect to the particular company that would be an investment company but for the exclusion provided by Section 3(c)(7) of the 1940 Act and advised by the investment adviser that the knowledgeable employee qualifies with respect to.
[11] *See* Release at 399 (citing proposed rule 206(4)-1(c)(2)(i)).
[12] *See id.* (citing proposed rule 206(4)-1(c)(2)(ii)).

that the definition of a non-retail person includes all knowledgeable employees as defined in Rule 3c-5.

A. Non-U.S. Person

Under the proposed amendments, a registered investment adviser would only be able to provide a non-retail advertisement to a client or investor in a pooled investment vehicle[13] that is a non-U.S. person if the adviser has adopted and implemented policies and procedures reasonably designed to ensure that such person is a non-retail person and made such a determination.[14] Historically, Congress and the Commission and its staff have excluded non-U.S. persons from certain substantive protections provided by the Federal securities laws, including the Advisers Act.

In adopting amendments to Section 205 of the Advisers Act in the National Securities Markets Improvement Act of 1996 (the "1996 Act"), Congress excluded an advisory contract with a person who is not a U.S. resident from the Section 205 prohibition on a registered investment adviser entering into a contract providing for performance based compensation.[15] Congress passed the 1996 Act following a report by the Commission's Division of Investment Management (the "1992 Report"), which proposed a nearly identical exclusion noting that "the Commission's interest in restricting the use by domestic advisers of performance fee contracts with their foreign clients is less compelling given the limited purposes of [the prohibition on a registered adviser entering into a contract providing for performance based compensation in] section 205(a)(1)."[16] We agree with this rationale and submit that non-U.S. persons should similarly be excluded from the proposed requirements for the presentation of performance results.

Accordingly, we suggest defining non-retail person to include a person who is not a U.S. person.

B. Qualified Client

We suggest expanding the definition of a non-retail person to include a person that meets the definition of a qualified client under Rule 205-3. In the Release, the Commission states that the standard for a non-retail person is intended to "provide a proxy for an investor's ability to access the kinds of resources and analyze information that would allow the investor to subject the information presented in Non-Retail Advertisements to independent scrutiny without the aid of additional disclosures or conditions."[17] When adopting Rule 205-3, the Commission

[13] Defined as any pooled investment vehicle as defined in Rule 206(4)-8(b) under the Advisers Act. *See* proposed rule 206(4)-1(e)(9).
[14] *See* proposed rule 206(4)-1(c); proposed rule 206(4)-1(e)(7).
[15] *See* National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290, 110 Stat. 3416 (1996) (codified in 15 U.S.C. § 80b-5(b)(5)).
[16] Division of Investment Management, U.S. Securities and Exchange Commission, Protecting Investors: A Half Century of Investment Company Regulation 245, 247–48 (1992).
[17] Release at 115.

noted that qualified clients are sufficiently "experienced and able to bear the risks associated with performance fees" to have the opportunity to negotiate for additional information needed to evaluate performance compensation, as well as the overall economic terms of their compensation arrangements with investment advisers.[18] We believe that such a person will also be able to analyze and understand performance information presented in non-retail advertisements.[19]

Accordingly, we suggest defining non-retail person to include a person who is a qualified client.

C. Accredited Investor

In the Release, the Commission considered treating accredited investors as non-retail persons. In discussing why the use of the accredited investor standard to define a non-retail person may not achieve the goals of the proposed amendments, the Commission indicated that it believes that analyzing certain performance information requires access to more specialized and extensive analytical and other resources than would be required to evaluate the merits and risks of an investment in an unregistered offering.[20] During the comment period for the Release, the Commission published Release No. IA-5407 (the "Accredited Investor Release"), which, among other things, proposed expanding the definition of accredited investor to add new categories of natural persons and entities.[21] In the Accredited Investor Release, the Commission notes that a characteristic of accredited investors is "the ability to gain access to information about an issuer or about an investment opportunity,"[22] and that the definition of accredited investor is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or fend for themselves render the protections of the Securities Act's registration process unnecessary."[23] The Commission's view of accredited investors as financially sophisticated persons that can fend for themselves and do not need the registration protections of the Securities Act appears to conflict with its position that such persons may be unable to evaluate the performance information included in a non-retail advertisement.

Accordingly, we suggest defining non-retail person to include a person who is an accredited investor.

D. Knowledgeable Employees

We agree with the Commission that it is appropriate to permit knowledgeable

[18] Exemption to Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, No. IA-996, 50 FR 48556 (Nov. 26, 1985).
[19] Rule 205-3 also provides for ongoing inflation adjustments to the net worth standard to meet the definition of a qualified client, which would reduce the risk that the standard will become outdated.
[20] *See* Release at 116.
[21] Amending the "Accredited Investor" Definition, Securities Act Release No. 33-10734, Exchange Act Release 34-87784, 85 Fed. Reg. 2574 (proposed Jan. 15, 2020) (to be codified at 17 C.F.R. Pts. 230 and 240).
[22] *See id.* at 16.
[23] *Id*.

employees to be treated as non-retail persons.[24] However, we believe that all persons who would be considered knowledgeable employees under Rule 3c-5 should be non-retail persons. Specifically, the Release indicates that only "certain" knowledgeable employees would be deemed non-retail persons.[25] In this regard, the proposed definition of non-retail person is limited to "[a] 'knowledgeable employee,' as defined in rule 3c-5 under the Investment Company Act of 1940, *with respect to* a company that would be an investment company but for the exclusion provided by section 3(c)(7) of the [1940 Act] and that is advised by the investment adviser."[26] Therefore, it appears that under the proposed amendments only a subset of knowledgeable employees with respect to an investment adviser would be treated as non-retail persons.

We believe that proposed rule 206(4)-1(e)(8)(ii) is overly narrow. As defined under Rule 3c-5, and as interpreted by the Commission staff, Rule 3c-5 "includes certain employees who participate in the investment activity of not only the Covered Fund, but also other Covered Funds, or investment companies the investment activities of which are managed by an Affiliated Management Person of the Covered Fund."[27] The Commission staff also takes the position that a Covered Fund can "[treat] an employee as a knowledgeable employee under Rule 3c-5(a)(4)(ii), notwithstanding the fact that the employee participates in the investment activities of Covered Separate Accounts (or a portfolio (or portion thereof) of a Covered Separate Account), rather than in the investment activities of a Covered Fund or an investment company."[28] We believe that the rationale for including a knowledgeable employee in the definition of non-retail person that is discussed by the Commission in the Release[29] applies equally to all persons that meet the definition of knowledgeable employees under Rule 3c-5.

Accordingly, we recommend that the Commission clarify that all persons who would be considered knowledgeable employees under Rule 3c-5 are non-retail persons, by removing the following phrase from proposed rule 206(4)-(1)(e)(8)(ii): "with respect to a company that would be an investment company but for the exclusion provided by section 3(c)(7) of the Investment Company Act and that is advised by the investment adviser."[30] This clarification will remove any doubt that an investment adviser is allowed to provide non-retail advertisements to all knowledgeable employees within the meaning of Rule 3c-5.[31]

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[24] *See* Release at 114.
[25] *See* Release at 70.
[26] Proposed rule 206(4)-(1)(e)(8)(ii) (emphasis added).
[27] Managed Funds Association, SEC No-Action Letter (Feb. 6, 2014) (the "MFA No-Action Letter"). A "Covered Fund" is a company that would be an investment company but for the exclusion provided by Section 3(c)(1) or 3(c)(7) of the 1940 Act. "Affiliated Management Person" is defined in the MFA No-Action Letter as "an affiliated person that manages the investment activities of a Covered Fund. . . ." *See also* Rule 3c-5(a)(4)(ii).
[28] *Id.* "Covered Separate Accounts" are defined in the MFA No-Action Letter as "separate accounts (or a portfolio (or portion thereof) of a separate account) for clients that are 'qualified clients' and are otherwise eligible to invest in the private funds advised by the Affiliated Management Person and whose accounts pursue investment objectives and strategies that are substantially similar to those pursued by one or more of those private funds."
[29] *See* Release at 113–14.
[30] *See* proposed rule 206(4)-1(e)(8)(ii).
[31] If the Commission accepts our recommendation to expand the definition of non-retail person to include a person that meets the definition of a qualified client under Rule 205-3 in section 1.B. *supra*, it would not be necessary to amend proposed rule 206(4)-1(e)(8)(ii). *See* Rule 205-3(d)(1)(iii).

II. Review and Approval Requirement

The proposed amendments would require an investment adviser to "have an advertisement reviewed and approved for consistency with the requirements of the proposed rule by a designated employee before, directly or indirectly, disseminating the advertisement. . . ."[32] We believe that this review and approval requirement would be inconsistent with the overriding approach of the Advisers Act and the rules thereunder to give each investment adviser the flexibility to design policies and procedures that are tailored to the particular adviser's business and related risks.[33] For example, in the adopting release for Rule 206(4)-7, the Commission explained: "Rule 206(4)-7 does not enumerate specific elements that advisers must include in their policies and procedures. Commenters agreed with our assessment that funds and advisers are too varied in their operations for the rules to impose a single set of universally applicable required elements. Each adviser should adopt policies and procedures that take into consideration the nature of that firm's operations."[34] This principle applies equally to the design of policies and procedures for the review and approval of advertisements. In the past both the Commission and its staff have been very clear that it would be inappropriate to apply a standardized set of compliance policies and procedures to all investment advisers.[35] We see no reason to change this longstanding approach.

Accordingly, we suggest eliminating the review and approval requirement.

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[32] *See* proposed rule 206(4)-1(d); Release at 190.
[33] *See infra* note 35.
[34] Compliance Programs of Investment Companies and Investment Advisers. 68 FR 74714, 74715–16 (Dec. 2003) (internal citations omitted).
[35] "[T]he adequacy of a compliance program can be determined only with reference to the profile of the specific firm and the specific facts and circumstances." National Examination Risk Alert by the Office of Compliance Inspections and Examinations, Volume II, Issue 1 (Jan. 4, 2012) *available at* https://www.sec.gov/about/offices/ocie/riskalert-socialmedia.pdf. "The compliance policies and procedures should address the practices and risks present at each adviser. No one standard set of policies and procedures will address the requirements established by the Compliance Rule for all advisers because each adviser is different, has different business relationships and affiliations, and, therefore, has different conflicts of interest. Because the facts and circumstances (*i.e.*, risks) that can give rise to violations of the Advisers Act are unique for each adviser, each adviser should identify its unique set of risks, both as the starting point for developing its compliance policies and procedures and as part of its periodic assessment of the continued effectiveness of these policies and procedures. Questions Advisers Should Ask While Establishing or Reviewing Their Compliance Programs (May 2006) *available at* https://www.sec.gov/info/cco/adviser_compliance_questions.htm. *See also* Proxy Voting by Investment Advisers, Advisers Act Release No. IA-2106; 17 C.F.R. Part 275 (March 10, 2003) ("We did not propose, and are not adopting, specific policies or procedures for advisers. Nor are we, as some commenters requested, providing a list of approved procedures. Investment advisers registered with us are so varied that a "one-size-fits-all" approach is unworkable. By not mandating specific policies and procedures, we leave advisers the flexibility to craft policies and procedures suitable to their businesses and the nature of the conflicts they face."); Political Contributions by Certain Investment Advisers, Advisers Act Release No. IA-3043; 17 C.F.R. Part 275 at 92 (July 1, 2010).

We appreciate the opportunity to comment on the Release. If you have any questions regarding this letter, please contact Patricia A. Poglinco at [redacted] or Robert Van Grover at [redacted].

Very truly yours,

Seward & Kissel LLP

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