sifma

asset management group

June 5, 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 Asset Management Group ("AMG") of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide additional comments to the Securities and Exchange Commission ("SEC" or "Commission") on the proposed amendments to the rules governing investment adviser advertisements and solicitation arrangements in Advisers Act Release No. 5407 (Nov. 4, 2019) (the "Proposing Release").[1] The Proposing Release would amend Rule 206 (4)-1 (the "Advertising Rule") and Rule 206(4)-3 (the "Solicitation Rule") under the Investment Advisers Act of 1940 ("Advisers Act"). SIFMA has reviewed and generally endorses the views and opinions in this letter.[2]

We would like to express our appreciation to the staff of the Division of Investment Management (the "Staff") for considering our prior comment letters[3] and for meeting with SIFMA AMG members to discuss certain aspects of both the Advertising Rule and the Solicitation Rule. The purpose of this letter is to provide additional information in response to those discussions and to address certain questions raised by the Staff.

SIFMA AMG is the voice for the buy-side within the securities industry and broader financial markets, which serve millions of individual and institutional investors as they save for retirement,

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[1] Investment Adviser Advertisements; Compensation for Solicitations, 84 FR 67518 (December 10, 2019).

[2] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit http://www.sifma.org.

[3] This letter supplements our two prior SIFMA AMG comment letters dated February 10, 2020.

education, emergencies, and other investment needs and goals. Our members represent U.S. asset management firms whose combined global assets under management exceed $34 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds.

As a threshold matter, SIFMA AMG wishes to reiterate the following themes, each of which we also addressed in prior comment letters:

- We urge the Commission to narrow the definition of an "advertisement" and the concept of a "solicitation" to focus on those communications and activities that implicate investor protection concerns. In the case of advertisements, we believe the definition should focus on communications that are actually designed to offer and promote advisory services. With respect to solicitation activity, we request that the Commission focus the definition on solicitation activities that are directed to – and therefore in connection with – specific clients or investors for the purpose of introducing them to a particular investment adviser in return for success-based compensation that is tied to the funding of an advisory account.

- In the case of the Advertising Rule, SIFMA AMG believes it is critical that the Commission eliminate the ***prior*** review and approval requirement and give investment advisers the flexibility to design advertising review controls that are consistent with the nature of their business and the way they advertise their services. Rather than the Commission defining the specific controls for advertising review, investment advisers should have the ability to leverage existing compliance processes and risk-based controls. This is particularly the case in today's environment where many investment advisers have had to redirect legal and compliance resources to respond to COVID-19 and, worse, are facing reductions in staff that will make the need to completely reengineer their entire compliance program challenging, if not unworkable.

- We request that the Commission continue to take a principles-based approach to the Advertising Rule that does not impose overly prescriptive requirements on advisers. This is particularly the case given the reliance on social media and other types of rapidly adaptable electronic communications.

Additionally, we wish to reconfirm the entirety of our prior comment letters. The fact that a comment SIFMA AMG provided in the prior comment letters is not included herein is not intended to suggest any lessened importance to our members. This letter focuses on providing additional information and comments to the Staff.

We also reiterate our request for a more extended implementation period. Legal and compliance departments are currently focusing on challenges related to COVID-19. While firms have weathered the first phase of the pandemic in the U.S., operating in a pandemic posture will remain a necessity for several more months, if not years. We therefore recommend an extended implementation period for both the Advertising Rule and the Solicitation Rule as firms adapt their existing systems and processes, while managing their businesses in a pandemic posture.

1. Supplemental Comments on the Proposed Amendments to the Advertising Rule

(a) Definition of an Advertisement - Adoption and Entanglement Theory

The proposed amendments to the Advertising Rule would define an advertisement to include all communications "by or on behalf of" an investment adviser. Based on our discussions, we understand that the Staff intended the "by or on behalf of" language to incorporate the entanglement and adoption theories, drawn from prior interpretations, into the definition of an advertisement. We request that the Commission make that intent explicit in the adopting release.

Specifically, we request that the Commission clarify that communications distributed by any person other than the investment adviser would not be considered to be an advertisement distributed "by or on behalf of" the adviser unless the adviser takes affirmative steps to "entangle" itself in the involvement of the content prior to dissemination or explicitly or implicitly endorses or approves the content after dissemination.[4] This would include communications disseminated by affiliates, intermediaries, solicitors, and other third parties. It would also apply to the personal use of social media by employees and other associated persons.[5] However, SIFMA AMG continues to believe that an investment adviser should not be deemed to have become entangled with or otherwise adopted third-party content if the investment adviser edits such content based on objective factors or to remove profane or unlawful content.

(b) Definition of an Advertisement - Brand Content

In our discussions, the Staff requested further clarification as to why the distribution and redistribution of "brand content" should not be considered an advertisement. Specifically, you asked us to clarify how these communications are not seeking to obtain clients.

We emphasize that brand (or corporate) content is distinct from financial services, including investment advisory services. Generally, brand content does not refer to financial services at all, but rather focuses on such things as corporate sponsorships, culture, philanthropy, community activity, social activism, and diversity and inclusion activities. In the asset management industry, this type of brand content is designed to promote the brand generally and can serve different purposes – attract and retain employees, enhance standing in the community, promote corporate-level brand recognition – but without focus on the firm's investment advisory services. Brand content is not "offering or promoting the investment adviser's investment advisory services" nor does it "seek to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser." In many instances, brand content is not even targeted at investment advisory clients and investors, nor is it necessarily industry-specific (meaning that brand content could just as easily be distributed by manufacturing or pharmaceutical companies). It is more often used to communicate corporate values and to generate community among employees. We submit that because brand content does not identify, offer, or promote particular financial

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[4] *See Commission Guidance on the Use of Company Web Sites,* SEC Rel. No. 34-58288 (Aug. 1, 2008), 73 Fed. Reg. 45862, 45870 (Aug. 7, 2008) ("2008 SEC Release"); *Use of Electronic Media,* SEC Rel. No. 33-7856 (April 28, 2000), 65 Fed. Reg. 25843, 25848-25849 (May 4, 2000).

[5] Investment advisers would still have policies and procedures governing the use of social media by employees and associated persons. We simply wish to clarify that communications disseminated by employees and associated persons through social media or otherwise would not be considered "advertisements" unless those communications meet the entanglement and adoption standard.

products or services, nor is it even necessarily targeted at clients and investors, it is sufficiently distinct from communications about advisory services such that it should not be subject to the Advertising Rule.

(c) Definition of Advertisement – Private Fund Investors

As we noted in our initial comment letter, we request that the Advertising Rule not apply to communications directed to investors in pooled investment vehicles. We make a similar request, below, with regard to the Solicitation Rule.

(d) Definition of Hypothetical Performance

Consistent with our prior comment letter on the Advertising Rule, SIFMA AMG requests that the Commission reconsider its approach to the definition of hypothetical performance. Specifically, we wish to clarify that the following types of performance presentations should not be considered hypothetical:

(i) Investment Analysis Tools

The Proposing Release contemplates that interactive tools that provide anticipated returns would be considered to be providing "targeted or projected performance results and would be subject to the proposed rule's conditions regarding hypothetical performance." We read this to mean that "investment analysis tools," as defined under FINRA Rule 2214, would be considered hypothetical performance.[6] As the Staff knows, FINRA has long excepted investment analysis tools that comply with the conditions of Rule 2214 from its general prohibition on projections. Many SIFMA AMG members are dually-registered firms or have broker-dealer affiliates that seek to continue to use such tools on both the broker-dealer and the investment adviser side. Accordingly, SIFMA AMG respectfully requests that the Commission expressly excepts investment analysis tools from the definition of hypothetical performance under the Advertising Rule.

(ii) Model Performance

We submit that rather than classifying all model performance as "hypothetical," the Commission take a more refined approach under which model portfolios that are: (a) actually seeded (meaning that there is either client or adviser money at risk); or (b) used by the investment adviser generating the performance or other advisers as the basis for non-discretionary advice (for example, in the context of a wrap program or research-based portfolio allocation models) are not considered to be hypothetical. Both of these situations are distinguishable from the situation where an adviser generates a large number of potential model portfolios, but only advertises the results of the highest performing model or, alternatively, circumstances under which an adviser creates only one portfolio, but manages it differently than if real assets were at risk.

(iii) Target Returns

While we acknowledge that the Proposing Release does not prohibit the use of hypothetical performance, we wish to reiterate that target returns should not be classified as hypothetical

[6] FINRA Rule 2214 permits member firms to use "investment analysis tools," which are defined as "an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices."

performance because they are commonly used to describe the objective of a particular fund or investment strategy, rather than a calculation of projected performance.

(e) Policies and Procedures Governing Hypothetical Performance

In the prior SIFMA AMG comment letter on the Advertising Rule, we requested that rather than imposing additional prescriptive conditions, the Commission allow investment advisers to continue to use hypothetical performance, subject to the general prohibitions. Our view is that the general prohibitions should be sufficient because they provide a much more refined and specific framework for evaluating performance presentations, including hypothetical presentations, than the general standards set forth in Advisers Act Section 206. For example, the general prohibitions restrict the use of unsubstantiated claims, untrue or misleading implications or inferences, the discussion of benefits without clearly and prominently discussing any materials risks or other limitations, presenting advice in a manner that is not fair and balanced, and including or excluding performance in a manner that is not fair or balanced. We submit that each of these provisions gives both the SEC examination and enforcement staff, as well as internal legal and compliance personnel, a number of dimensions to use in evaluating and articulating potential violations of the Advertising Rule.

If the Commission chooses not to rely on the general prohibitions to regulate hypothetical performance, then we respectfully submit that it reconsider the requirement that investment advisers adopt and implement policies and procedures reasonably designed to ensure that hypothetical performance is relevant to the financial situation and investment objectives of the person to whom the advertisement is disseminated. This proposed condition is intended to ensure that the adviser provides hypothetical performance only where "the recipient has the financial and analytical resources to assess the hypothetical performance" and the hypothetical performance would be relevant to the recipient's investment objective. We submit that, except in the case of sophisticated institutional investors, this standard is not one that can be implemented.

First, investment advisers simply cannot create a control environment based on a subjective assessment of whether each particular client or investor has access to the financial and analytical resources to assess the hypothetical performance that it receives. In the first instance, this assumes that an investment adviser has sufficient information to assess the financial situation and investment objectives of the person to whom the advertisement is disseminated. Advertisements are often presented before the establishment of an advisory relationship and they are not always designed for a specific client or investor. Further, it is not clear how an investment adviser would make this assessment and what evidentiary support it would be required to retain in order to substantiate a finding that the client does have appropriate financial and analytical resources.

Second, the Proposing Release and the proposed rule text are inconsistent as to whether the standard the Commission proposes needs to be applied on a client-by-client basis. The Proposing Release contemplates that "[r]easonably designed policies and procedures need not require an adviser to inquire into the specific financial situation and investment objectives of each potential recipient. Instead, such policies and procedures could identify the characteristics of investors for which the adviser has determined that a particular type or particular presentation of hypothetical performance is relevant and a description of that determination." However, the proposed rule text requires investment advisers to make that assessment based on the "***person*** to whom the advertisement is disseminated." (Emphasis added.)

Third, we submit that an assessment of whether the use of hypothetical performance is consistent with the "financial situation and investment objectives" of a particular client or investor does not seem to be the right standard for review. Rather than focus on the characteristics of the recipient, the better approach would be to ensure that the use of the hypothetical performance is relevant to the particular fund or investment strategy that is being advertised. Accordingly, we recommend that the Commission modify the condition set forth in proposed Rule 206(4)-1(c)(1)(V)(A) to prohibit the use of hypothetical performance unless the investment adviser:

> "Adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to, and is designed to further an evaluation of the performance and characteristics of, the portfolio, taking into consideration the type of clients and investors to which the advertisement is directed ~~the financial situation and investment objectives of the person to whom the advertisement is disseminated~~."

(f) Portability of Performance

In the context of predecessor performance, the Staff requested feedback on whether there are any potential downsides to codifying the Horizon no-action letter[7] in the Advertising Rule. The Staff also requested feedback on how to interpret certain defined terms that would be relevant to the codification of the Horizon test for the use of predecessor performance.

SIFMA AMG is supportive of incorporating the conditions set forth in the Horizon Letter into the Advertising Rule, however, it is our recommendation that rather than being reinterpreted, the conditions be presented as they are currently formulated in the no-action letter, which are as follows:

- The person or persons who manage accounts at the adviser were also those primarily responsible for achieving the prior performance results;
- The accounts managed at the predecessor entity are so similar to the accounts currently under management that the performance results would provide relevant information to prospective clients,
- All accounts that were managed in a substantially similar manner are advertised unless the exclusion of any such account would not result in materially higher performance;
- The advertisement is consistent with staff interpretations with respect to the advertisement of performance results; and
- The advertisement includes all relevant disclosures, including that the performance results were from accounts managed at another entity.

Consistent with this approach, we do not believe that there is any need to define the terms "primarily responsible" or to reconsider whether, in the case of an investment committee, there is a "substantial identity" of personnel. There are a myriad of different factual scenarios that occur in evaluating predecessor performance and it would be difficult, if not impossible, to address these different circumstances by rule. Further, we are not aware of enforcement actions or allegations of fraud relating to the use of predecessor performance that would warrant the need for additional

[7] *Horizon Asset Management, LLC*, SEC Staff No-Action Letter (Sept. 13, 1996) ["Horizon Letter"].

standards in this area. Accordingly, we reiterate our position that that general prohibitions set forth in proposed Rule 206(4)-1(a) will sufficiently prevent the presentation of predecessor performance results that are false or misleading.

2. Supplemental Comments on the Solicitation Rule

As noted above, we appreciate the Staff's time and thoughtful questions with regard to both the advertising and solicitation proposals. Following up on those conversations, we provide below supplemental comments on the Solicitation Rule. Within our supplemental comments on the disqualification provision, we also provide additional input on grandfathering and lengths of compliance periods in light of the current COVID-19 situation, which has the potential to cause recurrent dislocation episodes for firms in the near term future, as well as reductions in force, as we noted above. We offer these comments on a general basis, beyond commenting on the compliance time that would arise from the expanded disqualification provisions.

(a) Scope of the Definition of a Solicitor

We reiterate the comments in our February 10, 2020 letter urging the Commission to reframe the definition of solicitation to focus on intentional (or true) solicitation activity, which would encompass: (i) solicitation activities directed at specific clients; and (ii) compensation from the adviser that is incentive-based (or success-based compensation) and tied to the funding of an account. We remain concerned that an overly broad definition of solicitation may sweep a broad range of advertisements or ancillary services and activities into the rule, even when there is no intentional solicitation or agreement with the advisor to solicit.

We recommend changes in two parts of the proposed Solicitation Rule text addressing the definition of solicitor, as illustrated below in redline. The proposed redline would narrow the definition of solicitor while maintaining the investor protective intent of the Solicitation Rule.

> 275.206(4)-3 Compensation for solicitors
>
> (a) As a means reasonably designed to prevent fraudulent, deceptive, or manipulative acts, practices, or courses of business within the meaning of section 206(4), it is unlawful for an investment adviser that is registered or required to be registered under section 203 of the Act to compensate a solicitor, directly or ~~indirectly~~, ~~for~~ in connection with ~~any~~ solicitation activities, unless the investment adviser complies with …
>
> …
>
> (c) Definitions. For purposes of this section,…
>
> …
>
> (4) *Solicitor* means any person who, directly or indirectly, solicits ~~any~~ a specific client ~~or private fund investor~~ for, or refers ~~any~~ a specific client ~~or private fund investor~~ to,

an investment adviser, in connection with the receipt of compensation based on the establishment of an advisory relationship.[8]

The proposed changes in redline would ensure that the definition is narrowed to capture intentional solicitation activities directed to specific clients and rewarded through success-based compensation. We also recommend that the SEC provide additional guidance in the adopting release that the rule applies to solicitation pursuant to an agreement, rather than capturing advertising [or] ancillary services or refer-a-friend program for non-professional solicitors.

(b) Expanding the Solicitation Rule to Address All Forms of Compensation

We reiterate our request that the SEC narrow the non-cash compensation component of the Solicitation Rule as well as apply additional exemptions to align further with FINRA's 2016 proposed approach to non-cash compensation. As currently proposed, the Solicitation Rule would both result in a compliance burden for tracking low dollar amount non-cash compensation as well as limit industry practices (such as corporate sponsorships or attending training and education events of other firms). We expand below on our comments from our initial letter with regard to these two areas and in relation to the FINRA 2016 proposal, including low dollar amount non-cash compensation in the section on exemptions (see below).

We note that with respect to training or education meetings, there is no express exemption in the Solicitation Rule for these meetings. Furthermore, the Proposing Release discusses that such meetings may be considered compensation, but provides no additional guidance. Therefore, we request the addition of an explicit exemption that exempts non-cash compensation in the form of training and education meetings and corporate sponsorships from the Solicitation Rule as long as firms comply with certain parameters or conditions. Currently fees related to trainings, education meetings, and corporate sponsorships are sometimes waived; without an express exemption, the Solicitation Rule could burden firms with additional tracking or altogether preempt beneficial industry education and networking. We encourage the Commission to draw from the FINRA 2016 proposal which includes conditions such as prior approval, attendance not being preconditioned on the achievement of a certain sales targets, appropriate location (whether an office or other facility) and no payment for additional guests. In light of recent events, we also request that an "appropriate location" expressly include online and virtual activities.

We also urge the Commission further describe what constitutes non-cash compensation and more specifically define how to differentiate between types of compensation, as opposed to taking an all-encompassing approach that covers compensation before and after potential solicitation activity. Further alignment with the FINRA non-cash compensation rule proposal would reduce compliance burden as our members could leverage compliance resources and expertise across broker-dealer and investment adviser business. We feel strongly that explicit alignment between the SEC Solicitation Rule non-compensation regime and the FINRA regime, along with the incorporation of the "in connection with" concept into the definition will help reduce confusion for both firms and investors and further focus the Solicitation Rule on the activity the Commission is trying to regulate.

(c) Exemptions from the Solicitation Rule

[8] As discussed above in connection with the Advertising Rule and in our prior comment letters, SIFMA AMG requests that activity involving private fund investors be exempt from the requirements of both the Advertising and Solicitation Rules.

We appreciate the inclusion of a de minimis exemption in the Solicitation Rule, and note that this exemption could be helpful for some non-cash compensations such as meals and entertainment. We recommend raising the amount from $100 to $250 to better align with FINRA requirements.

(d) Disqualifications For Persons Who have Engaged in Misconduct, Including Grandfathering Provision

We reiterate our appreciation for the work of the Staff on modernizing the disqualification provisions, incorporating both elements of the Reg D Rule 506 standard as well as elements of the disqualification provisions in the existing rule. We urge further alignment to the Reg D Rule 506 framework, particularly with regard to aligning length of time of specific disqualification provisions. We recommend the addition of a five-year span for application of 275.206(4)-3(a)(3)(iii)(A), to mirror the equivalent provision in Reg D Rule 506. We also recommend additional clarification in 275.206(4)-3(a)(3)(iii)(B)(1) with regard to the U.S. and foreign court components to either further align the provision to Reg D Rule 506 or highlight differences that firms should be aware of.

With regard to grandfathering, we reiterate our support of the Proposing Release's "grandfathering" option to allow advisers to rely on existing SEC no-action letters under Section 206(4) and Rule 206(4)-3 with regard to the current rule's disqualification provisions. We would appreciate the continuation of that no-action relief under the new rule, particularly in light of the fact that the proposed Solicitation Rule greatly expands the disqualification provisions that are present in the existing rule. For solicitors that have acted in good faith, it would be unreasonable to now require these relationships to be terminated, particularly because the underlying conduct has already been identified and remediated in accordance with any disciplinary settlement.

Finally, as noted above, we also reiterate our request for an extended implementation period of 24 months in order to give firms the ability to adapt their existing systems and process to address what may be significant changes to the Solicitation Rule, even while managing through the current and ongoing challenges presented by the COVID-19 pandemic.

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SIFMA AMG sincerely appreciates the opportunity to comment and the Commission's consideration of our views. We stand ready to provide any additional information or assistance that the Commission might find useful. Please do not hesitate to contact either Timothy Cameron at 202.962.7447 or tcameron@sifma.org or Lindsey Keljo at 202.962.7312 or lkeljo@sifma.org with any questions.

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