sifma
asset management group

February 10, 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 our comments to the Securities and Exchange Commission ("SEC" or "Commission") on the proposed changes to the cash solicitation rule in Advisers Act Release No. 5407 (Nov. 4, 2019) (the "Proposing Release").[1] SIFMA has reviewed and generally endorses the views and opinions in this letter.[2]

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, 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.

The Proposing Release updates two rules under the Investment Advisers Act of 1940 ("Advisers Act") that govern how investment advisers advertise their services and solicit clients. The comments below relate to the proposed amendments to Advisers Act Rule 206(4)-3 (the

[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.

"Solicitation Rule" or the "Proposed Solicitation Rule").[3] We understand that the amendments are designed to update the current rule to better reflect the evolution of the advisory business and the related referral practices.

SIFMA AMG supports the Commission's objective of modernizing the current rule and we appreciate that the Commission has proposed a number of changes designed to simplify the implementation of the Solicitation Rule. At the same time, however, the Proposing Release also expands the application of the Solicitation Rule in a number of respects. Specifically, the Proposing Release would extend the application of the Solicitation Rule to cover both cash and non-cash compensation, as well as to solicitation for investors in private funds. In addition, the Proposed Solicitation Rule would include greatly expanded statutory disqualification requirements with language beyond both the existing rule and the statutory disqualification requirements in Rule 506 of Regulation D and would similarly expand the disclosure of conflicts of interest in the separate written disclosure document. The Proposed Solicitation Rule also includes certain partial exemptions - for impersonal investment advice and affiliated solicitors, and full exemptions, for *de minimis* compensation and nonprofit programs. We list our comments below in the order in which they appear in the Proposing Release; however, we wish to highlight our concerns with the broadness of the scope of the Proposed Solicitation Rule and its related guidance , the expansion to including non-cash compensation, the inclusion of solicitation for private fund investors, and the broadening of the statutory disqualification requirements.

1. Scope of the Rule: Who is a Solicitor?

The Proposed Solicitation Rule defines a "solicitor" to mean "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." This definition is consistent with the existing definition, with the addition of persons who solicit investors in private funds. However, the Commission takes an expansive interpretation, noting that promoters who are compensated for providing testimonials or endorsements may be considered to be solicitors under certain circumstances. The Proposing Release also substantially expands the registration requirements applicable to solicitors 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. SIFMA AMG requests that the Commission reconsider its expansive interpretation of the concept of a solicitor.

A. *The definition of a solicitor should focus on activity that is directed at specific clients or investors in return for success-based compensation.*

SIFMA AMG believes that it would be more appropriate to reframe the definition of a solicitor to focus on true solicitation activity that raises the policy considerations the solicitation regime is designed to address. To assist the Commission in better focusing the definition of solicitation, we recommend using these two combined criteria: (i) persons whose solicitation activities are directed at specific clients or investors (e.g., through one on-one meetings or personalized communications); and (ii) persons to whom the adviser provides incentive-based compensation that is tied to the funding of an account. Both these suggested changes better focus the Solicitation Rule on the

[3] Please note that we submitted a separate comment letter in response to the advertising proposal in the Proposing Release.

activity that creates the conflict of interest. We are concerned that if the definition of solicitation is predicated solely on the receipt of compensation, the result will be to sweep a broad range of advertisements, services, and other activities into the Solicitation Rule, regardless of whether the activity is actually intended to solicit clients and investors.

The broad interpretation of solicitation activities will cover practices that merely involve introductions between investors and advisers - or even just passing along marketing information about an investment adviser's capabilities - but do not involve the payment of cash compensation or non-cash compensation that is tied to the success of the introduction. Our members are concerned these circumstances may qualify as referrals because of the Proposed Solicitation Rule's expansive reach, particularly where the adviser may have separately compensated the entity that is making an introduction (or its affiliates), or may in the future compensate such person (or its affiliates) for activities completely unrelated to introductions. These situations can and should be differentiated from true solicitation activity, in which a person refers a potential investor to an adviser and the person receives some form of compensation specifically for that referral.

We recommend, therefore, that the Proposed Solicitation Rule's definitional structure focus on compensation that is based on successful referrals, pursuant to true solicitation activity. Such an approach better reflects the underlying goals of the rule and the conflicts that the rule seeks to expose. This clarification has several benefits as it focuses the Proposed Solicitation Rule on intentional solicitation activity, as opposed to informational conversations or introductions. Furthermore, a focus on true solicitation would eliminate any question as to whether day-to-day informational conversations that occur in the normal course would be subject to the Solicitation Rule.

B. *The SEC should better differentiate between advertising and solicitation activities.*

As we noted above, SIFMA AMG is focused on a broad interpretation that would result in the application of the Proposed Solicitation Rule to certain types of advertisements. The Proposing Release explains that a promoter (a person providing a compensated testimonial or endorsement in a registered investment adviser's advertisement) may also, depending on the facts and circumstances, be acting as a solicitor. We are pleased that, despite the underlying assumption about the overlap of the Advertising Rule and the Solicitation Rule, the SEC outlines three considerations that might dictate whether the promotional or advertising activities rise to the level of a solicitation: (i) the nature of the compensation; (ii) the amount of control the adviser has over the content or dissemination of a promoter's communication; and (iii) the extent to which the referral to the adviser is directed to a particular client or investor. We support the introduction of these factors, though we urge the Commission to further narrow the compensation prong to focus on compensation that is tied to the success of the referral. All advertising arrangements are designed to be success-based in some respect because advisers do not want to pay for advertising that is not effective. The question is whether that compensation is actually tied to the success of the referral. We submit that there are many advertising arrangements that include compensation that do not raise the conflict of interest considerations the solicitation regime was designed to address.

C. *The SEC should return to its position that solicitors remain exempt from investment adviser registration.*

We note that the Commission's discussion of the registration requirements for solicitors under Section 202(a)(11) of the Advisers Act introduces a significant policy change. Specifically, the Proposing Release reverses the SEC's longstanding position that "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."[4] Instead, the Proposing Release notes 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."[5] Under this approach, solicitors would have an obligation to evaluate whether they would need to register as an investment adviser or whether they 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.

SIFMA AMG acknowledges that modernizing a rule requires re-examination of existing assumptions. However, the reversal of the SEC's position regarding solicitor registration does not include discussion of any policy reasons to make this change. We note that the 1979 release based its view regarding solicitor exemption from registration on the rule's requirement that the investment adviser oversee the activities of the third party solicitor.[6] The Proposed Solicitation Rule still requires such oversight, such that elimination of the exemption from Advisers Act registration is not tied to a specific policy rationale or commensurate change to the rule. It is not clear why the SEC is proposing to remove the exemption from Federal investment adviser registration, but at the same time is requiring advisers to have a reasonable basis for believing that the solicitor has complied with the terms of the written solicitation agreement, which in turn requires the solicitor to perform its solicitation activities in accordance with Advisers Act Sections 206(1), 206(2), and 206(4).[7] If the adviser continues to have a reasonable-basis oversight obligation over the solicitation activities, the solicitor should continue to have an exemption from investment adviser registration. We are also concerned that the Proposing Release addresses this significant reversal in guidance only briefly, without specifically eliciting comment, while making the assumption that solicitors could and should be registered. The solicitor business model was never intended to be a regulated business model, but rather one of compensation for referrals, with additional investor protective measures built in through disclosure; the SEC's focus was to expose and cure any conflicts resulting from referral fees, not impose additional regulation on third parties who provide referrals.[8] Further, the

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[4] Requirements Governing Payments of Cash Referral Fees by Investment Advisers, 44 FR 42126 (Jul. 18, 1979) (the "1979 Adopting Release").

[5] Proposing Release, 67571 n.346.

[6] 1979 Adopting Release, 42129. See also Requirements Governing Payments of Cash Referral Fees by Investment Advisers, 43 FR 6095 (Feb. 18, 1978) (the "1978 Proposing Release").

[7] *See* Proposing Release, 67647 (proposed rule 206(4)-3(a)(2)).

[8] It is noteworthy that, when proposing a solicitation rule in 1978, the Commission considered either prohibiting the payment of cash referrals by advisers to solicitors, or adopting the current rule. There is no

determination of whether a solicitor is subject to investment adviser registration is a fact intensive analysis, and many solicitors have no experience operating as regulated entities. Accordingly, we expect that the Commission's approach here will have a chilling effect that will restrict solicitation activity solely to regulated entities.

Further, we are unsure of how the Commission's approach would apply to client referral programs. The Commission cannot mean to propose that clients would be required to register as investment advisers in order to participate in a refer-a-friend program. We request that the Commission revisit its approach to eliminating the policy-based exemption from investment adviser registration. If the Commission intends for certain clients to be covered by the Proposed Solicitation Rule, then we suggest that the Commission provide comprehensive guidance on what it means to be "engaged in the business of" providing investment advice to make clear that refer-a-friend programs, and other occasional solicitation arrangements, do not constitute engaging in the business of providing investment advice.

D. *The SEC should clarify that broker-dealer receipt of solicitation compensation is incidental to brokerage activities.*

We recommend that the Commission use the Adopting Release to clarify that, for a broker-dealer, receipt of solicitation compensation under the Advisers Act does not constitute "special compensation" within the solely incidental exclusion from the Advisers Act.[9] We note specifically the Commission's Solely Incidental Interpretation discussion, which states that the broker-dealer exclusion is conjunctive (the broker-dealer must both provide investment advice that is solely incidental to the conduct of his business as a broker-dealer and the broker-dealer must receive no special compensation). The advice prong is inapplicable in the solicitation realm. However, as solicitation does result in broker-dealer compensation, we request clarification that solicitation compensation is not special compensation for purposes of the solely incidental exclusion.

2. Expanding the Rule to Address All Forms for Compensation

The Proposing Release expands the application of the Proposed Solicitation Rule's requirements to all forms of compensation paid, directly or indirectly, to a person for solicitation activities. According to the Commission, the types of compensation used by advisers in referral arrangements have evolved beyond direct cash payments. In this regard, the Commission takes the position that provision of non-cash compensation for referrals creates the same conflicts of interest as cash compensation for referrals. The Commission's expansion of the Proposed Solicitation Rule to include non-cash compensation is based on the underlying policy goals of the rule, which is to expose the solicitor's economic interest in steering an investor to an adviser and ensure disclosure of the solicitor's bias as a result of the conflict.[10] The Commission intends for the Proposed Solicitation Rule to apply to all non-cash compensation, including, but not limited to, directed brokerage, sales awards or other prizes, training or education meetings, outings, tours, or other

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mention in either the 1978 Proposing Release or the 1979 Adopting Release of curing solicitor-related conflicts through imposing additional regulation on solicitors.

[9] Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, 84 FR 33681 (July 12, 2019) ("the Solely Incidental Interpretation").

[10] Proposing Release, 67574

forms of entertainment, and free or discounted advisory services. The Proposing Release states, however, that the Commission does not consider attendance at training and education meetings to be non-cash compensation, provided that attendance is not provided in exchange for solicitation activities. The Proposing Release provides guidance on timing of compensation, noting that compensation by an adviser may occur before or after the solicitor engages in its referral activities, and that, regardless of when compensation for solicitation is provided, such compensation would be within the scope of the Solicitation Rule. SIFMA AMG respectfully submits that the Commission better define the application of the Solicitation Rule to non-cash compensation.

A. *The SEC should narrow its approach to non-cash compensation.*

SIFMA AMG understands that as part of the process of modernizing the Proposed Solicitation Rule, the Commission is taking a holistic approach and including all compensation. We recognize that advisers have developed new and novel compensation arrangements with solicitors, but are concerned about the expansiveness of non-cash compensation. The combination of indirect benefits and non-cash compensation, in particular, may well result in unintended consequences for SIFMA AMG's members, as the breadth of the definition may pick up indirect benefits not actually tied to a solicitation activity, and may create traps for the unwary, especially with respect to "indirect" compensation paid to affiliates.[11]

The Commission's guidance including (in the scope of non-cash compensation) the concept of "the adviser providing investment advice that directly or indirectly benefits the solicitor"[12] is overly broad. This broadness could pull in unrelated arrangements between the adviser and the solicitor. We are also generally concerned about non-cash compensation triggering application of the Solicitation Rule to informal referral arrangements, such as between lawyers and advisers.

We respectfully suggest that the Commission provide further guidance around what constitutes direct or indirect compensation, or create a clearer distinction between the two. The Proposed Solicitation Rule does not clearly distinguish compensation that is for solicitation from ordinary compensation an adviser pays to a broker-dealer for *bona fide* execution services (or to other service providers for *bona fide* services). Further, our members have voiced concerns that various types of investment recommendations could be re-characterized as non-cash compensation under the Proposed Solicitation Rule. For example, a number of our members direct trades for client portfolios to brokerage firms with whom they also have a solicitation agreement for cash compensation. Under the Proposed Solicitation Rule, the selection of a broker-dealer could be re-characterized as non-cash compensation, even though this conflict would already be disclosed by the adviser, separately from the solicitation arrangement.

We also recommend that the Commission take the position that solicitor compensation is competitive/proprietary information and not appropriate for Form ADV Part 1A. While the

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[11] The Proposed Solicitation Rule is potentially expansive enough that, prior to making a referral, a person would need to inventory all relationships they or their affiliates have with an adviser to determine if there is a source of compensation that requires disclosure. For example, if a person refers a prospective client to an adviser, and the person's affiliate serves as the custodian in a wrap program that the adviser recommends for that prospective client, the referral may be deemed solicitation activity.

[12] Proposing Release, 67573.

Commission has proposed to include collection of this information on Form ADV, we are strongly opposed to this suggestion.

B. *The SEC should consider applying the Proposed Solicitation Rule to compensation occurring after the solicitation unless the solicitation agreement specifically includes compensation prior to the solicitation activities.*

SIFMA AMG also has some concern about the Commission's statement that compensation occurring before or after the solicitation activities is captured by the scope of the Proposed Solicitation Rule.[13] We believe this formulation to be over-broad, and could potentially capture activity outside the scope of any solicitation agreement, particularly when applied in hindsight. There is also the risk that, in the instance where there are both a solicitation agreement and another agreement (e.g. for other types of indirect revenue to the solicitor or its affiliates), that the current Proposed Solicitation Rule would prevent advisers from distinguishing when compensation is paid in exchange for solicitation activities and when it is not, given the timing of the activities and compensation. We respectfully suggest that the rule cover only compensation occurring after solicitation activity, unless the solicitation agreement specifically contemplates compensation prior to the solicitation activities.

C. *The SEC should apply additional exemptions to align with FINRA's proposed approach to non-cash compensation*

Finally, we respectfully suggest that the Commission consider adding further exemptions to the final rule to align with the approach being pursued by FINRA. In 2016, FINRA released a proposed amendment to its gifts, gratuities, and non-cash compensation rules.[14] 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, while the Commission discusses that such meetings may not be considered compensation, there is no express exemption in the Proposed Solicitation Rule. This omission 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 Solicitation Rule, "sales awards or other prizes" would be considered non-cash compensation. We are concerned that this proposal conflicts with the FINRA approach. In particular, dual registrants may have to follow conflicting regimes, specifically as broker-dealers (who may act as solicitors on behalf of investment advisers) are in the midst of Regulation Best Interest implementation. We therefore request that the Commission consider adding an internal sales contest exemption to align with the exemption being pursued by FINRA.

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[13] *See* Proposing Release, 67574.

[14] *See* FINRA Regulatory Notice 16-29: Gifts, Gratuities and Non-Cash Compensation Rules: FINRA Requests Comment on Proposed Amendments to Its Gifts, Gratuities and Non-Cash Compensation Rules, August 2016.

3. Compensation for the Solicitation of Existing and Prospective Investors

The Proposed Solicitation Rule will expand the scope of the rule to include the solicitation of existing and prospective private fund investors. The Commission believes that this would increase protections to such investors primarily by making them aware of a solicitor's financial interest in the investor's investment in a private fund and prohibiting the use of disqualified solicitors under the Proposed Solicitation Rule. The Commission also states that the expansion of the Proposed Solicitation Rule to cover private fund investors is consistent with its update to the proposed changes in the Advertising Rule.

A. *The SEC should not reverse existing no-action letter guidance related to the application of the Proposed Solicitation Rule to private funds.*

SIFMA AMG understands the Commission's desire to increase investor protections, but respectfully disagrees with the proposal to include private fund investors in the scope of the Proposed Solicitation Rule. Our key concern is that the Proposed Solicitation Rule reverses longstanding practice. In particular, in the Mayer Brown LLP, SEC Staff No-Action Letter (Jul. 28, 2008) (the "Mayer Brown Letter"), the Commission stated that the current rule does not apply to compensation to a person for soliciting investors or prospective investors for, or referring investors or prospective investors to, an investment pool managed by the adviser. The Commission's position, as stated in the Mayer Brown Letter, has become fundamental guidance for SIFMA AMG's membership. Numerous relationships between advisers and solicitors operate on this principle, and reversing it would cause significant disruption. SIFMA AMG's members believe that many investment advisers rely heavily on the Mayer Brown Letter to guide their treatment of compensation paid in exchange for referrals of prospective investors who are not clients. We respectfully submit that such disruption is unnecessary and ask the Commission to reconsider its inclusion of solicitation of all private fund investors.

Private fund investors receive appropriate investor protections in several ways. First, all private fund investors are protected through Advisers Act Section 206(4) and Rule 206(4)-8, which prohibit advisers to a pooled investment vehicle from making untrue statements or engaging in any other fraudulent, deceptive, or manipulative practice, as well as the broader anti-fraud provisions of the Securities Act of 1933 and Securities Exchange Act of 1934. Further, because soliciting for funds is generally brokerage activity, retail clients purchasing private funds will also have the protections of Regulation Best Interest and Form CRS. Insofar as an affiliated broker-dealer acts as a private placement agent for private funds sponsored and managed by an affiliated investment adviser, interests are inherently aligned to the benefit of investors. Affiliated broker-dealers and advisers have the same interests with respect to ensuring compliance with laws and regulations and avoiding poor practices that could create reputational as well as regulatory risk. We also note that private fund investors derive benefit from the protections afforded under Rule 506 of Regulation D. Added regulatory requirements would increase the compliance burden without a material benefit to investors.

Should the Commission proceed with reversing the Mayer Brown Letter, we respectfully request that the Commission consider including a grandfathering provision for relationships that were established based on the principles in the Mayer Brown Letter. Specifically, where an investment adviser has, in reliance on the Mayer Brown letter, established a compensation arrangement for solicitation of investments in a pooled investment vehicle, we ask the Commission state that such

compensation payments are not to be subject to the requirements of the Proposed Solicitation Rule, if finalized as proposed. This grandfathered treatment would apply so long as investment assets in question remain in the same pooled investment vehicle that was the subject of the original solicitation - even if the adviser continues to make payments in compensation for the original solicitation.

B. *The SEC should approach solicitation of existing and prospective investors in private funds as it does the solicitation of existing and prospective investors in RICs and BDCs.*

The Proposing Release includes a discussion on why the Commission does not apply the Proposed Solicitation Rule to solicitation of existing and prospective investors in registered investment companies ("RICs") and business development companies ("BDCs") for two reasons. The SEC notes the existence of financial intermediaries (e.g., broker-dealers) in these transactions and the fact that the SEC believes that these investments are largely sought through advice or advertisements, both of which are already subject to regulatory requirements. The differences the Commission highlights between investors in private funds as opposed to RICs and BDCs should also include the investment advisory regulatory and disclosure framework that directly impacts private fund management. We disagree with the Commission's assumption that private fund investors are less protected from solicitor conflict than RICs or BDCs, as private funds are subject to disclosures and, as mentioned above, these investors will have the protections of Regulation Best Interest and Form CRS.

4. Solicitor Disclosure

The Proposed Solicitation Rule continues to require the delivery of a separate disclosure statement, although the SEC is removing the requirement that it be in writing and allowing that it may be delivered by the adviser or the solicitor. The Proposed Solicitation Rule modifies the current rule's disclosure requirements, particularly with regard to additional details about compensation and conflicts of interest. Under the Proposed Solicitation Rule, an investment adviser will be prohibited from compensating solicitors unless the adviser and solicitor have, in the written agreement, designated the solicitor or the adviser to provide to investors at the time of any solicitation activities a separate disclosure containing specified information. The Proposed Solicitation Rule would require that the solicitor disclosure state: (i) the name of the investment adviser; (ii) the name of the solicitor; (iii) a description of the investment adviser's relationship with the solicitor; (iv) the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor; (v) any potential material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or the compensation arrangement; and (vi) the amount of any additional cost to the investor as a result of the solicitation.

New to the Proposed Solicitation Rule is the requirement to disclose any material conflicts of interest on the part of the solicitor resulting from the investment adviser's relationship with the solicitor and/or the compensation arrangement. Additionally, the Proposed Solicitation Rule provides additional guidance on timing of delivery for mass solicitation, and permits either the solicitor or the adviser to deliver the solicitor disclosure, rather than requiring that the solicitor deliver it, provided the written agreement designates the party responsible for delivering the disclosure. The Proposed Solicitation Rule would also remove the requirement that the disclosure be "written."

A. *SIFMA AMG recommends that the Commission considers eliminating the separate disclosure requirement in light of other disclosure requirements outside the solicitation regime.*

SIFMA AMG appreciates the Commission proposing that the solicitor disclosure remain separate; however, the volume of disclosures to investors continues to grow generally, including the new delivery requirements of Form ADV Part 3 / Form CRS. Therefore, the practicality of maintaining separate delivery (to maintain salience and impact) will continue to be a challenge for advisers. To this end, we recommend that the Commission allows more latitude on the separateness of the delivery of the disclosure, thus allowing advisers to combine this delivery with other disclosures. We note that our members have tools to make disclosures more prominent without requiring a separate document.

B. *SIFMA AMG supports the Proposed Solicitation Rule allowing disclosure delivery by the solicitor or the adviser.*

SIFMA AMG strongly supports disclosure delivery becoming a responsibility that could be fulfilled by the solicitor or the adviser, provided there is an agreement between the solicitor and the adviser as to who should deliver the disclosure. While we note above that a separate disclosure document may not be necessary, should such a document remain necessary under the rule, SIFMA AMG supports the flexibility of the adviser being able to make delivery. Advisers choosing to deliver the disclosure can benefit from verifying delivery has occurred without relying on solicitors, who are external third parties; we also note that advisers who have a system to oversee solicitor disclosure will not need to change their currently workable arrangements. This is an example of the Proposed Solicitation Rule allowing for investor needs to be met, while providing flexibility for advisers.

C. *The SEC should reconsider requiring the disclosure of additional conflicts of interest because the requirement is duplicative of Form ADV's disclosure requirements.*

The Proposing Release requests comment on whether the requirement to expand the solicitor disclosure to include a statement of any potential material conflicts of interest resulting from the investment adviser's relationship with the solicitor is duplicative of other disclosure requirements. SIFMA AMG notes the duplicative nature of this additional disclosure, particularly as such conflicts would be contained in the adviser's Form ADV disclosure requirements (including Form ADV Part 3 / Form CRS). Furthermore, broker-dealers also have conflicts of interest disclosure obligations pursuant to Regulation Best Interest and Form CRS. SIFMA AMG recommends reconsiderations of this requirement as it is duplicative for broker-dealers and investment advisers (whether they are the solicitors or those relying on the solicitors, respectively). If the SEC determines that the additional disclosure is necessary, we recommend exclusion of registered advisers and broker-dealer solicitors from the additional disclosure based on the existing disclosure obligations, including under Regulation Best Interest and Form CRS.

D. *SIFMA AMG generally supports the proposed modified timing of delivery for mass solicitations.*

With regard to timing, the Proposed Solicitation Rule contemplated modifying timing of the delivery of the solicitor disclosure for solicitations that are conducted through mass communications.[15] In those instances, where solicitation occurred through mass communications, we agree with the SEC's proposal that the solicitor disclosure be delivered at the time of solicitation or as soon as reasonably practicable thereafter. We agree with the SEC's assessment that it may not be practicable to deliver the solicitor disclosure at the time of initial solicitation and appreciate the SEC viewing delivery of the disclosure promptly after the investor expresses an initial interest in the adviser's services as satisfying the solicitor disclosure requirement. We also agree with the Proposing Release noting that, if the adviser is responsible for disclosure delivery, "as soon as reasonably practicable" in this instance should be when the investor first reaches out to the adviser with an indication of interest. We agree that this modification continues to promote investor protection, while providing both advisers and solicitors with flexibility.

5. Written Agreement

The Proposed Solicitation Rule retains the same principle as in the current rule, which requires the compensation arrangement between investment adviser and solicitor be made pursuant to a written agreement between the parties. The written agreement must: (i) describe with specificity the solicitation activities of the solicitor and the terms of the compensation for the solicitation activities; (ii) require that the solicitor perform its solicitation activities in accordance with sections 206(1), (2), and (4) of the Advisers Act; and (iii) require and designate the solicitor or the adviser to provide the investor, at the time of any solicitation activities or, in the case of a mass communication, as soon as reasonably practicable thereafter, with a separate disclosure meeting the conditions of the rule.

The Proposed Solicitation Rule will also eliminate some of the current requirements, specifically that the solicitor deliver the adviser's brochure, and the requirement that the solicitor undertake to perform its duties consistent with the instructions of the adviser. It will modify the current requirement that the written agreement contain an undertaking by the solicitor to perform his duties under the agreement in a manner consistent with the provisions of the Act and the rules thereunder, replacing it with the more specific requirement that the solicitor agree to perform its solicitation activities in accordance with sections 206(1), (2), and (4) of the Act.

SIFMA AMG is wholly supportive of these changes. We believe that the proposed changes remove unnecessary duplication in the written agreement provision, and will streamline the solicitation process.

6. Adviser Oversight and Compliance; Elimination of Additional Provisions

The Proposed Solicitation Rule requires advisers to have a reasonable basis for believing that the solicitor has complied with the written agreement between the parties. The Proposed Solicitation Rule would also: (i) eliminate the current rule's requirement for the adviser to obtain a signed and

[15] Mass communications include communications that appear to be personalized to a single investor (and nominally addressed to only one person), but are actually widely disseminated to multiple investors, as well as impersonal outreach to large numbers of persons. *See* Proposing Release, 67577.

dated acknowledgment from the client that the client has received the solicitor's disclosure; and (ii) eliminate the current rule's explicit reminders of advisers' requirements under the Act's special rule for solicitation of government entity clients and their fiduciary and other legal obligations.

The oversight requirement would eliminate the current requirement that the investment adviser: (i) make a bona fide effort to ascertain whether the solicitor has complied with the agreement; and (ii) has a reasonable basis for believing that the solicitor has so complied. The proposed requirements effectively require that advisers monitor their compensated solicitors for compliance with the written agreement requirements. The Proposing Release notes that what constitutes a "reasonable basis" will depend on the circumstances, but should generally involve periodically making inquiries of a sample of investors referred by the solicitor in order to ascertain whether the solicitor has made improper representations or has otherwise violated the agreement with the investment adviser.

The SEC should re-consider the addition of a requirement to monitor solicitor compliance or allow investment advisers to rely on certifications by the solicitor. SIFMA AMG agrees with many of the changes to the written agreement provision that remove unnecessary compliance obligations. However, we respectfully consider the move to a requirement that investment advisers monitor compliance of its solicitors is overly burdensome. Our view is based on the fact that this is a new and novel requirement for advisers, and is currently not part of their business. As a result, advisers will have to develop new systems and bring in new resources in order to meet these requirements. This will in turn increase the cost of the adviser's business, which could result in the adviser passing the cost on to potential investors. For the same reason, this requirement would also increase compliance costs with regard to the adviser's relationship with the solicitor. We also believe that periodic inquiries into investors will only serve to displease investors, who are looking to reduce the burden of investing rather than increase it.

Alternatively, we request that the Commission consider allowing advisers to rely on periodic certifications by solicitors that they are in compliance with any obligations imposed on them under the written agreements provision of the Proposed Solicitation Rule. This approach would avoid any increase in burden on the adviser and investor, and would efficiently allow the adviser and solicitor to comply with their obligations.

7. Exemptions

In addition, the Proposed Solicitation Rule includes four exemptions: partial exemptions for impersonal investment advice and advisers' in-house solicitors or other affiliated solicitors; a *de minimis* threshold, below which the rule would not apply; and an exemption for certain nonprofit programs. SIFMA AMG appreciates the opportunity to comment on these four exemptions.

A. *The SEC appropriately retained and streamlined the impersonal advice exemption.*

The Proposed Solicitation Rule would retain the impersonal investment advice exemption found in the current rule. This exemption would cover solicitation activities for investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts. The Proposed Solicitation Rule also adopts the Form ADV definition of "impersonal investment advice," which would replace the current rule's definition of "impersonal advisory services," to achieve consistency with Form ADV. However, the Commission does not believe that this

modification would change the types of persons to whom the exemption applies. The Proposed Solicitation Rule would maintain the current rule's partial exemption for compensated solicitors of impersonal investment advice, with one modification: such solicitors would not be required to enter into a written agreement with the adviser. The Commission states that applying the written agreement provision to such solicitors could result in an expense without a sufficient corresponding benefit. The Commission has stressed that the partial exemption would continue to be available only to solicitation that is solely for impersonal investment advice. Further, advisers could not compensate a solicitor for the solicitation of impersonal investment advice if the solicitor is disqualified.

SIFMA AMG approves of the Commission's decision to retain the impersonal investment advice exemption. This exemption is a long-standing feature of the regime covering solicitation, and continues to be a useful option for introducing investors to advisory services. We also approve of the decision to streamline aspects of this exemption. Aligning the definition of "impersonal investment advice" will reduce confusion, and removing the requirement to enter into a written agreement with persons who solicit for impersonal investment advice will reduce the administrative burden on parties.

B. ***The SEC should further refine the exemption for in-house solicitors and other affiliated solicitors.***

The Proposed Solicitation Rule intends to keep the partial exemption for solicitors who are controlled by, or under common control with, the adviser, provided the affiliation is disclosed to the client at the time of the solicitation or referral. The Proposed Solicitation Rule will maintain the majority of the current structure, as well as make several modifications. A key proposed modification is that a solicitor will not be required to disclose its affiliation with an adviser if the affiliation is readily apparent and the adviser has documented the solicitor's status at the time of entering into the solicitation agreement—we note this exemption applies solely to individuals who actively solicit as part of their in-house roles, as opposed to generally sales-focused staff. Furthermore, in many instances involving in-house or affiliated solicitors, the investor is on notice that the solicitor has a stake in soliciting the investor, and that the recommendation is not coming from a neutral party. In these instances, full disclosure is not necessary.

The Proposed Solicitation Rule will also expand the partial exemption to cover any solicitor which controls, is controlled by, or is under common control with, the investment adviser that is compensating the solicitor. The Proposed Solicitation Rule expands the exemption on the well-established position that advisers already exercise oversight and authority over in-house solicitors, and written agreements are not needed between affiliated persons. For these reasons, in-house and affiliated solicitors will also continue to be exempt from the rule's separate compliance requirement. Finally, the Proposed Solicitation Rule will continue to apply the disqualification provision to in-house and affiliated solicitors. The SEC notes that it believes investors should be protected from solicitation by persons with certain disciplinary events, regardless of whether the solicitation is conducted in-house, by an affiliate, or by a person unaffiliated with the adviser.

1. The SEC should provide further guidance on the term "readily apparent" in order to reduce the potential for confusion.

SIFMA AMG welcomes the Commission's approach to this provision, noting that the proposed modifications will reduce unnecessary regulation for advisers and solicitors. While we agree that some affiliations do not need to be disclosed because of the obvious and close relationship between adviser and solicitor, we believe the final rule would be improved with the inclusion of further guidance with respect to the term "readily apparent." Currently, the discussion in the release focuses on the names of the adviser and solicitor, and where the solicitor identifies itself (e.g., through notations on business cards) as an affiliate of the adviser. However, our members have raised questions about situations in which the affiliation is already well-known, such as where an adviser or solicitor is working with a long-standing client that is aware of the relationship, or where the investor is clearly advised, either orally or through other documentation, about the affiliation. As drafted, the term "readily apparent" has the potential to create unnecessary confusion.

2. The SEC should amend the partial exemption so that it also includes independent contractor solicitors.

We also suggest that the exemption specifically include solicitors that are engaged as independent contractors for an adviser. Our members are increasingly using independent contractors to fill solicitation activities, which provides flexibility for advisers of all size. Advisers exercise control over the independent contractor for these activities, but it is not clear from the language in the Proposed Solicitation Rule whether this type of relationship would qualify for the exemption. We believe it would be inefficient, and may discourage the use of independent contractors, if these limited and defined relationships are required to meet the full disclosure requirements.

3. The SEC should consider removing the requirement that the disqualification provision also apply to in-house and affiliated solicitors.

Finally, we respectfully request that the Commission reconsider its position on applying the disqualification provision to in-house and affiliated solicitors. While we agree with the desire to protect investors from persons with a certain disciplinary history, we are also concerned that this approach is overly restrictive. As the Commission recognizes, advisers exercise greater control over in-house and affiliated solicitors. There is therefore greater opportunity to educate, train, and control the solicitor, thereby reducing the risk of problematic behavior. Allowing certain disqualified solicitors to be employed as in-house or affiliated solicitors would also provide a controlled environment for the solicitor to continue their training and demonstrate rehabilitation. SIFMA AMG therefore requests that the Commission consider allowing certain disqualified persons to be employed as a solicitor by an adviser or with an affiliate to an adviser.

C. *The SEC should consider adopting a principles-based approach to or increase the threshold of the de minimis exemption*

The Proposed Solicitation Rule includes a new exemption for solicitors who receive *de minimis* compensation from an adviser. The Commission states that it would be overly burdensome for advisers and solicitors that engage in solicitation for *de minimis* compensation to comply with the rule, in light of the benefits. The Commission has proposed a threshold of $100 or less (or the

equivalent value in non-cash compensation) paid over the preceding 12 months. However, if an adviser expects to make payments to a solicitor in excess of the *de minimis* amount, even though it has not yet done so, the Commission recommends that the adviser carefully consider whether it wishes to avail itself of the exemption.

SIFMA AMG broadly agrees with the inclusion of a threshold for triggering the Proposed Solicitation Rule. Firms report that technology has increased the referrals for minimal, if any, compensation or reward. Further, many advisers reward one-off or infrequent referrals with gifts, a practice acknowledged by the Commission by reference to the threshold set by FINRA Rule 3220 (Influencing or Rewarding Employees of Others) ("FINRA Gifts Rule").

However, we respectfully request that the Commission consider adopting a principles-based approach rather than a specific dollar threshold. An approach based on reasonableness, propriety, and avoiding conflicts would protect investors and resolve challenges for firms that operate in multiple diverse markets across the United States, where the buying power of $100 varies greatly. Under a principles-based approach, the Commission could exclude from the definition of "compensation" gifts and other entertainment that is neither so frequent nor so extensive as to raise any question of propriety. For example, the Commission could exclude branded office supplies, promotional items, occasional meals and occasional tickets to sporting events or comparable entertainment.

If the Commission concludes that a specific dollar value is necessary, then SIFMA AMG respectfully recommends increasing the threshold to $250. The proposed $100 threshold is antiquated, with its roots in a FINRA rule that was adopted in 1992. Indeed, FINRA has recently explored raising the $100 threshold to, at a minimum, account for inflation since the rule was adopted.[16] This higher amount is consistent with the median proposed gift limit observed in connection with FINRA's research,[17] and it is reasonable and not so high that it would materially increase the potential for conflicts of interest and risk of abuse. An annual gift limit of $250 also would be consistent with the U.S. Department of Labor's ("DOL") standard for gifts and other consideration given by a service provider to a fiduciary of a plan subject to the Employee Retirement Income Security Act of 1974 as well as reporting and disclosure on DOL Form LM-10 under the Labor-Management Reporting and Disclosure Act of 1959.[18]

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[16] *See* FINRA Regulatory Notice 16-29: Gifts, Gratuities and Non-Cash Compensation Rules: FINRA Requests Comment on Proposed Amendments to Its Gifts, Gratuities and Non-Cash Compensation Rules, August 2016.

[17] FINRA Retrospective Rule Review Report: Gifts, Gratuities and Non-Cash Compensation (December 2014) ("FINRA Gifts Report"), available at https://www.finra.org/sites/default/files/p602010.pdf (last visited *February 6, 2020*).

[18] See DOL's Employee Benefits Security Administration (EBSA) Enforcement Manual, available at https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement/oe-manual-full (last visited *February 6, 2020)*; and DOL's Office of Labor-Management Standards (OLMS) Form LM-10 – Employer Reports Frequently Asked Questions (March 19, 2019), available at https://www.dol.gov/olms/regs/compliance/lm10_faq.htm (last visited *February 6, 2020*).

D. *Nonprofit Programs*

The Proposed Solicitation Rule introduces another exemption for certain types of nonprofit programs. The rationale for this new exemption is that the potential for a solicitor to demonstrate bias towards one adviser or another is sufficiently minimal to make the protections of the rule unnecessary. Advisers may avail themselves of the exemption by following a simple framework, which includes: (i) having a reasonable basis for believing that the solicitor is a nonprofit program; (ii) the participating advisers compensate the solicitor only for costs reasonably incurred with operating the program; (iii) the solicitor provides the clients with a list of at least two advisers based on non-qualitative criteria; and (iv) the solicitor and adviser disclose to the client certain information about the arrangement. In situations where an adviser is being matched with a nonprofit program, and the compensation to the solicitor is on a costs-only basis, SIFMA AMG agrees that there is little, if any, need for full disclosure obligations.

We appreciate this exemption for nonprofit programs, but note that the same type of approach could be helpful for for-profit entities who provide matching of clients and advisers based on objective criteria. It is not clear why the program would have to operate on a non-profit basis if the program is designed to match advisers with potential clients on the basis of objective factors and advisers take other steps to minimize compensation incentives such as implementing a neutral compensation structure that is not tied to the success of the referral. We recommend the Commission does not restrict this type of program solely to nonprofit entities and programs.

8. Disqualification for Persons Who Have Engaged in Misconduct

The Proposed Solicitation Rule includes a significant update to the disqualification provision of the current rule. Under the Proposed Solicitation Rule, advisers are prohibited from compensating, directly or indirectly, someone who the adviser knows, or, in the exercise of reasonable care, should have known is an "Ineligible Solicitor."[19] An Ineligible Solicitor is defined as a person who, at the time of the solicitation, is either subject to a "Disqualifying Commission Action"[20] or is subject to any "Disqualifying Event."[21] The reasonable care standard will require advisers to make inquiries into the solicitor in order to comply with Proposed Solicitation Rule's obligations. The Commission has chosen, based on precedent and practice with other Commission rules, not to prescribe the level, method, or frequency of due diligence.

The definition of a Disqualifying Commission Action covers a greater range of Commission actions. Disqualifying Commission Action will include: Commission opinions and orders that bar, suspend or prohibit a person from acting in any capacity under the Federal securities laws; and Commission orders to cease and desist from violating antifraud provisions of the securities laws, selling unregistered securities, or violating other mandatory disclosure requirements. In contrast, the definition of a Disqualifying Event includes orders and convictions from U.S. courts and an extensive list of regulators. The list of regulators includes: Federal agencies, such as the Commodity Futures Trading Commission and Federal banking agencies; state authorities, including the state

[19] *See* explanation of the definition in the Proposing Release, 65787.

[20] *See* explanation of the definition in the Proposing Release, 65789.

[21] *See* explanation of the definition in the Proposing Release, 65789-65791.

securities commissioners, state insurance commissioners, state banking supervisors; and self-regulatory organizations, such as FINRA, registered exchanges and national securities associations.

SIFMA AMG offers its comments below, with an emphasis on easing the burden that this greatly expanded statutory disqualification requirements would impose, as the statutory disqualification provision includes language beyond both the current rule and the statutory disqualification requirements in Rule 506 of Regulation D.

A. *The SEC should include a grandfathering provision.*

In the Proposing Release, the Commission asks specifically whether a "grandfather" provision should be included to allow advisers to rely on letters they received from Commission staff stating that the staff would not recommend enforcement action to the Commission under section 206(4) and rule 206(4)-3. In these situations, the adviser paid cash solicitation fees to a solicitor that was subject to particular disciplinary events that fall within the current rule's disqualification provision.

We ask that the Commission consider including a grandfather provision exempting the engagement of all solicitors subject to a Commission no-action letter as described above, so long as the solicitors continue to comply with the conditions specified in the no-action letters and, except for the disciplinary events described in the applicable letter, would not otherwise be ineligible solicitors under the Proposed Solicitation Rule. Advisers and solicitors have relied on these no-action letters to build networks and relationships. The underlying conduct has been revealed to and discussed with the Commission, and, for parties that have acted in good faith and in compliance with any conditions, it would be unreasonable to now require these relationships to be terminated.

We ask that the Commission also consider including grandfather treatment for contractual solicitation arrangements that have been entered into based on the current rule. We respectfully submit that requiring investment advisers to apply new legal standards to solicitations that were in compliance with all applicable law at the time the contract was entered into does not meet general standards of fairness, and is also commercially burdensome and disruptive to clients and investors.

B. *The SEC should also delay implementation of the expanded requirements of the disqualification provision to give advisers sufficient time to adopt the necessary policies and procedures.*

SIFMA AMG further requests that the Commission delay implementation of the expanded requirements of the disqualification provision for one year following the effective date of the final rule. SIFMA AMG respectfully submits that the proposed disqualification regime is significantly more detailed and onerous than the current rule. Advisers will be required to develop and implement the necessary policies and procedures to comply with the proposed requirements, as well as conduct due diligence on the solicitors with which they do business. For larger advisers, this will be a significant burden and many firms will need time to complete the process with reasonable care. Without some form of delayed implementation, the Proposed Solicitation Rule will require advisers to freeze any relationship that has not completed the due diligence process. As a result, SIFMA AMG believes that this process has the potential to cause serious disruption to larger adviser firms that have extensive solicitor relationships.

C. *The SEC should align the scope of the disqualification provision so that it is consistent with other disqualification regimes, such as Rule 506 of Regulation D.*

While SIFMA AMG understands the Commission's desire to develop a comprehensive disqualification regime, our members are concerned about competing requirements between the expansive scope of the proposed disqualification provision and other disqualification regimes. The Proposed Solicitation Rule imposes greater disqualification requirements than other comparable disqualification regimes, such as the "Bad Actor" disqualification regime under Rule 506. In particular, the Proposed Solicitation Rule goes beyond Rule 506's requirements and includes, in the definition of Disqualifying Commission Action, Commission opinions or orders barring, suspending, or prohibiting the person from acting in any capacity under the federal securities laws. As a result, the proposed disqualification provision is inconsistent with other Commission disqualification regimes.

We therefore respectfully suggest that the Commission align the disqualification provision with the Bad Actor requirements of Rule 506 of Regulation D. This will increase compliance across regimes and decrease confusion with respect to competing definitions regarding what constitutes a disqualifying action or event.

D. *The SEC should clarify and take further steps to ensure that the conditional carve-out is not overly punitive or restrictive.*

The Proposed Solicitation Rule also includes a conditional carve-out from the definition of Ineligible Solicitor for "Non-Disqualifying Commission Actions." Non-Disqualifying Commission Actions would mean: (i) an order pursuant to section 9(c) of the Investment Company Act (commonly referred to as a "waiver"); or (ii) a Commission opinion or order that is not a Disqualifying Commission Action. In order for the conditional carve-out to apply: (i) the person must have complied with the terms of the opinion or order, including, but not limited to, the payment of disgorgement, prejudgment interest, civil or administrative penalties and fine; and (ii) for a period of ten years following the date of each opinion or order, the person must include in its solicitor disclosure a description of the acts or omissions that are the subject of, and the terms of, the opinion or order.

SIFMA AMG is generally supportive of the conditional carve-out from the definition of Ineligible Solicitor. We agree that solicitors that have received a waiver or are the subject of an opinion or order that is not a Disqualifying Commission Action should not receive the same permanent sanction as solicitors who are the subject of a Disqualifying Commission Action. Our members have noted that the waiver process itself can be unclear, so additional clarity surrounding use of the waiver in the context of the final rule would be helpful.

However, we are concerned that it may be overly punitive to require that a solicitor include in its disclosure, for a period of ten years, a description of the acts or omissions that are the subject of the waiver or an opinion or order that is not a Disqualifying Commission Action. The ten year time period is significant, and may have the effect of forcing such persons out of business rather than making them come into compliance. In such a situation, the conditional carve-out does not achieve its goal - that is, to allow solicitors who are *not* the subject of a Disqualifying Commission Action to continue to do business, provided they are in compliance with the terms of the opinion or order. As

a result, SIFMA AMG suggests lowering the time period for the inclusion of the events in the solicitor's disclosure to five years.

We also suggest that the Commission clarify the requirements for including acts or omissions that are the subject of the Disqualifying Commission Action in the solicitor's disclosure. As drafted, it is unclear how the Proposed Solicitation Rule would affect solicitors that are currently subject to a waiver or opinion or order that is not a Disqualifying Commission Action. For example, it is an open interpretation that such a person would still need to disclose the relevant acts or omissions for ten years after the final rule comes into effect.

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SIFMA AMG sincerely appreciates the opportunity to comment and your consideration of these 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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