

SEC Proposes Amendments to the Investment Advisers Act Rules on Advertising and Cash Solicitation

NOVEMBER 14, 2019

On November 4th, the Securities and Exchange Commission (“SEC”) announced proposed amendments, which can be found [here](#), intended to modernize the advertising and cash solicitation rules (Rule 206(4)-1 (the “Advertising Rule”) and Rule 206(4)-3 (the “Solicitation Rule”), respectively) that apply to investment advisers that are registered (or required to register) under the Investment Advisers Act of 1940 (the “Advisers Act”). Neither rule has been substantively amended since their adoptions in 1961 and 1979, respectively. If adopted, the proposed amendments will be the first significant revision to these rules in more than four decades, and will alter the advertising and solicitation rules for, and compliance obligations of, registered investment advisers, including registered advisers to private equity funds and other private funds.

The SEC press release and fact sheet [issued](#) along with the proposed amendments (the “Press Release”) indicated that the proposed amendments are intended to revise the Advertising Rule and the Solicitation Rule “to reflect changes in technology, the expectations of investors seeking advisory services, and the evolution of industry practices.”

The amendments to the Advertising Rule “would replace the current rule’s broadly drawn limitations with principles-based provisions.” These new provisions include general prohibitions of certain advertising practices with more tailored restrictions and requirements for certain specific types of advertisements. For example, the proposed amendments are tailored to permit the use of testimonials, endorsements, and third-party ratings, subject to certain conditions, including consideration of the advertisement’s intended audience. These proposals represent a significant departure from both current rules and SEC staff positions (expressed in countless no-action letters) that have developed over the years.

The amendments to the Solicitation Rule would “expand the rule to cover solicitation arrangements involving all forms of compensation, rather than only cash compensation, eliminate requirements duplicative of other rules, and tailor the required disclosures solicitors would provide to investors.” The proposed amendments would also revise the current Solicitation Rule provisions regarding disciplinary events that would disqualify a person or entity from acting as a solicitor.

In addition to these revisions to the Advertising Rule and the Solicitation Rule, the proposed amendments would amend: Form ADV, to request additional information about investment advisers’ advertising practices; and Rule 204-

2 (the “Books and Records Rule”), to implement changes related to the proposed amendments to the Advertising Rule and the Solicitation Rule.

Proposed Advertising Rule Amendments

As noted above, the proposed amendments to the Advertising Rule are intended to “replace the current rule’s broadly drawn limitations with principles-based provisions.” The proposed amendments would apply to all SEC-registered investment advisers and investment advisers that are required to be registered with the SEC, but would not apply to investment advisers that are not required to register as investment advisers with the SEC, including exempt reporting advisers and state-registered advisers.

The proposed amendments would revise the definition of “advertisement” to incorporate changes related to advances in technology and evolving industry practices. The proposed definition includes “any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser’s investment advisory services or that seeks to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser.” This definition includes four categories of exclusions:

- Live oral communications that are not broadcast;
- Certain responses to unsolicited requests for specified information about the investment adviser or its services;
- Advertisements, other sales material, or sales literature that is about a registered investment company or a business development company and is within the scope of other SEC rules; and
- Information required to be contained in a statutory or regulatory notice, filing, or other communication.

The proposed amendments would also generally prohibit certain advertising practices with the intent of preventing fraudulent, deceptive, or manipulative acts. Specifically, the proposed amendments would prohibit advertisements that:

- Make an untrue statement of a material fact, or omit a material fact necessary to make the statement made, in light of the circumstances under which it was made, not misleading;
- Make an unsubstantiated material claim or statement;
- Make an untrue or misleading implication about a material fact relating to an investment adviser, or make a statement that is reasonably likely to cause an untrue or misleading inference to be drawn concerning such a material fact;
- Discuss or imply any potential benefits without clear and prominent discussion of associated material risks or other limitations associated with the potential benefits;
- Refer to specific investment advice where such investment advice is not presented in a fair and balanced manner;
- Include or exclude performance results, or present time periods for performance, in a manner that is not fair and balanced; or
- Are otherwise materially misleading.

The proposed amendments would permit testimonials, endorsements, and third-party ratings, subject to the general anti-fraud principles described above and certain additional limitations. The use of testimonials and endorsements would be subject to specified disclosures, including whether the person giving the testimonial or endorsement is a client and whether compensation had been provided by or on behalf of the adviser. The use of third-party ratings also would be subject to specified disclosures, including any compensation provided and certain criteria pertaining to the preparation of the rating.

The proposed amendments would also place limitations on the performance information that may be included in advertising materials. Specifically, the proposed amendments would prohibit advertisements that include the following:

- Gross performance results unless the adviser provides (or offers to promptly provide) a schedule of fees and expenses deducted to enable calculation of net performance;
- Any statement that the calculation or presentation of performance results has been approved or reviewed by the SEC;
- Performance results from fewer than all portfolios with substantially similar investment policies, objectives, and strategies as those being offered or promoted in the advertisement, subject to limited exceptions;
- Performance results of a subset of investments extracted from a portfolio, unless the adviser provides (or offers to promptly provide) the performance results of all investments in the portfolio; and
- Hypothetical performance, unless the adviser adopts and implements policies and procedures reasonably designed to ensure that the performance is relevant to the financial situation and investment objectives of the recipient and the adviser provides certain specified information underlying the hypothetical performance.

The proposed amendments would also provide additional disclosure requirements for advertisements targeted to a retail audience. Specifically, the proposed amendments would require advisers to include net performance results along with any presentation of gross performance results, and would require advisers to present certain performance results using one-, five-, and 10-year periods.

Finally, the proposed amendments would require an adviser to submit advertisements to an internal pre-use and approval process. A designated employee of the adviser would be required to review and approve the advertisement for consistency with the new Advertising Rule requirements prior to dissemination, except for advertisements that are communications disseminated only to a single person or household or to a single investor in a pooled investment vehicle; or live oral communications broadcast on radio, television, the internet, or any similar medium. A designated employee for this review process “should be competent and knowledgeable regarding the proposed amendments’ requirements” and “generally should include legal or compliance personnel of the adviser,” but the proposed amendments does not define a specific employee or role because this requirement “is intended to provide advisers with the flexibility to assign the responsibilities of advertising reviews to any qualified employee.” The qualified employee, however, cannot be the same person who prepared the advertisement.

Proposed Solicitation Rule Amendments

The proposed amendments to the Solicitation Rule are largely intended to expand the scope of the rule and refine the provisions of the rule relating to:

- written agreements between the adviser and the solicitor;
- disclosures required to be provided to persons solicited by the solicitor; and
- events that disqualify persons from serving as solicitors.

First, the proposed amendments would bring within the scope of the Solicitation Rule any arrangement in which an adviser pays cash *or* non-cash compensation to a solicitor (not just cash compensation as is currently the case). Thus, an adviser would be prohibited from paying a solicitor any form of compensation, directly or indirectly, for any solicitation activities unless the adviser complies with the terms of the rule. Non-cash compensation would be broadly construed to include, for example, compensation such as directed brokerage, sales awards, or other prizes, training or education meetings, outings, tours or other forms of entertainment, and free or discounted advisory services.

Second, the proposed amendments would bring within the scope of the Solicitation Rule an adviser’s payment of cash or non-cash consideration to any solicitor for soliciting persons to invest in private funds managed or advised by the adviser, not simply for soliciting “clients” for the adviser, as is currently the case. This proposal represents a significant departure from the current Solicitation Rule (as interpreted by the SEC staff) and industry practice, which do not require a registered adviser to comply with the Solicitation Rule in connection with paying solicitors to refer prospective *investors* to private funds managed or advised by the adviser.

Of course, even now, persons who receive compensation from a registered adviser for soliciting prospective investors in private funds managed or advised by the adviser are potentially subject to other SEC regulations by virtue of engaging in solicitation activities (notwithstanding the fact that such activities are not subject to the Solicitation Rule), such as by acting as an investment adviser within the meaning of Section 202(a)(11) of the Advisers Act, or as a broker or dealer within the meaning of Section 3(a)(4) of the Securities Exchange Act of 1934. The proposed changes to the Solicitation Rule will not affect this issue, so advisers and solicitors will continue to need to examine whether particular solicitation activities involve the solicitor in investment advisory or broker-dealer activity and, if so, whether the solicitor is appropriately registered or exempt from registration.

As is currently the case, the proposed amendments would require an adviser's compensation to a solicitor to be made pursuant to a written agreement, unless an exemption applies. Such a written agreement would be required to include:

- a description of the solicitation activities and compensation;
- a requirement that the solicitor perform its solicitation activities in accordance with certain provisions of the Advisers Act; and
- a requirement that certain disclosure be delivered to clients/investors (and a designation of whether the adviser or the solicitor is responsible for providing such disclosure). Unlike the current Solicitation Rule, the proposed amendments would not require such disclosure to be provided to the client/investor in writing.

The proposed amendments also include a new disclosure requirement intended to highlight the solicitor's financial interest in the client's/investor's choice of an investment adviser. Specifically, in addition to the disclosures currently required by the Solicitation Rule, the party responsible for providing disclosures to the client/investor would be required to disclose 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 between the adviser and the solicitor.

As discussed above, the proposed amendments would require the adviser and the solicitor to designate, in their written agreement, which of the two is responsible for providing the required disclosures to clients/investors. Unlike the current Solicitation Rule, the proposed amendments would not require that such disclosures be provided to the client/investor in writing. Further, the proposed amendments would eliminate the requirement for the adviser to obtain a signed and dated acknowledgment from the client/investor that the client/investor has received the required disclosures.

With respect to adviser oversight of solicitors, the proposed amendments, like the current rule, would require that the adviser have a reasonable basis for believing that the solicitor has complied with the requirements imposed on it pursuant to its written agreement with the adviser, which would largely remain the same (except that the solicitor would no longer be required to agree to deliver Part 2A of the adviser's SEC Form ADV to persons it solicits, or comply with the instructions of the adviser in connection with its solicitation activities).

The proposed amendments would include several exemptions from the requirements of the Solicitation Rule. The proposed amendments would substantially retain the partial exemptions in the current rule for solicitors that refer investors for impersonal investment advice; and solicitors that are employees of, or otherwise affiliated with, the adviser. However, these arrangements would no longer be subject to the written agreement requirement imposed by the current rule.

The proposed amendments also add two new full exemptions from the Rule's requirements: an exemption for *de minimis* compensation to solicitors (compensation valued at \$100 or less in a 12-month period); and an exemption for advisers that participate in certain types of nonprofit programs.

Finally, the proposed amendments contain an expanded list of disciplinary events that would disqualify a person from acting as a solicitor, subject to a limited exception.

Proposed Form ADV and Books and Records Rule Amendments

The proposed amendments would amend Item 5 of Part 1A of Form ADV (by adding a new Item 5.L) to refine the information reported about an adviser’s advertising practices to align with the new requirements of the revised Advertising Rule.

The proposed amendments would also amend the Books and Records Rule to align with the proposed amendments to the Advertising Rule and the Solicitation Rule.

SEC Review of Existing No-Action Letters and Related Guidance

Finally, the staff of the SEC Division of Investment Management is reviewing the SEC’s guidance relating to the application of the advertising and solicitation rules to determine whether such guidance should be withdrawn in connection with adopting any of the provisions in the proposed amendments. The proposed amendments list the guidance currently under consideration by SEC staff, and requests that interested parties identify any additional letters or guidance they believe should be withdrawn and the reason for such a request.

SEC Request for Comment

The SEC has requested public comments on the proposed amendments. The public comment period will remain open for 60 days after the proposed amendments is published in the [Federal Register](#).

If you have any questions about the proposed amendments or would like assistance submitting a comment to the SEC, please feel free to contact us.

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