SEC Proposes Amendments to the Advertising and Solicitation Rules

Authored by Mark Perlow, Russel Perkins, Michael Sherman, David Vaughan, Christine Schleppegrell, Aaron Withrow, Ashley Rodriguez, Logan Dalton and Teresa Jung

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The U.S. Securities and Exchange Commission has proposed amendments to Rule 206(4)-1 – Advertisements by Investment Advisers (Current Advertising Rule) and Rule 206(4)-3 – Cash Payments for Client Solicitations (Current Solicitation Rule) under the Investment Advisers Act of 1940, as well as technical amendments to Rule 204-2 (Current Recordkeeping Rule) and Form ADV, Part 1A (separately, Proposed Advertising Rule and Proposed Solicitation Rule, and collectively, Proposal).[1] The Proposal was published in the Federal Register on December 10, 2019 with a comment period ending February 10, 2020.

The Proposed Advertising Rule, if adopted, would dramatically revise and modernize the regulatory framework for investment adviser and private fund marketing materials. It would replace the current set of rigid prohibitions (particularly those relating to testimonials and past specific recommendations) with a more flexible, principles-based approach, and would codify and rationalize the current patchwork of guidance provided through SEC enforcement actions and Staff no-action letters (particularly as these apply to performance presentation).[2] Among other things, the Proposed Advertising Rule seeks to:

- Bring the regulatory scheme into the 21st century and adapt it from primarily paper-based premises to a more technology-neutral basis that recognizes the realities of the Internet, social media and mobile applications;
- Eliminate unnecessary or outdated requirements;
- Distinguish in many key instances between retail and institutional investors and more appropriately calibrate the Current Advertising Rule's requirements to the differing needs of such investors; and
- Rely more expressly on compliance policies and procedures, as well as additional reviews by advisers, than under the Current Advertising Rule.

While the changes in the Proposed Solicitation Rule are less fundamental, they also reflect a significant modernization of the Current Solicitation Rule with a more streamlined structure.

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1 Investment Adviser Advertisements; Compensation for Solicitations, Release No. IA-5407 (Nov. 4, 2019); 84 Fed. Reg. 237 (Dec. 10, 2019). Unless otherwise noted, Section and Rule references are to the Advisers Act and rules thereunder. There may be instances where this *OnPoint* tracks the Proposal without the use of quotation marks.

2 The Proposal includes a list of 56 no-action letters related to advertising and 134 no-action letters related to cash solicitation, which the Staff is reviewing for potential withdrawal if the Proposal is adopted and if such letters were "moot, superseded, or otherwise inconsistent with the amended rules." The SEC has invited comment as to whether other no-action letters should be withdrawn if the Proposal is adopted.

Proposed Amendments to the Advertising Rule

Structure

The Proposed Advertising Rule consists of: a number of general prohibitions, tailored restrictions or conditions for the use of certain advertising practices; specific requirements for performance advertising; distinctions between retail and non-retail audiences; and review and approval requirements.

Scope

Proposed Definition of "Advertisement"

"Advertisement" would be defined under the Proposed Advertising Rule as "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." However, the Proposed Advertising Rule would specifically exclude:

- Live oral communications not broadcast on radio, television, the Internet or any other similar medium;
- Communications by an investment adviser that do no more than respond to unsolicited requests for information (with certain exceptions);
- Advertisements or other sales material or sales literature about a registered investment company (RIC) or business development company (BDC) within the scope of Rule 482 or Rule 156 under the Securities Act of 1933; and
- Information required in a statutory or regulatory notice, filing or other communication.

The proposed definition differs from the Current Advertising Rule's definition of "advertisement"[3] in that, among other things:

- Additional types of communications would be covered, including (as explicitly discussed in the proposing release) email, text, instant messaging, electronic presentations, video, podcasts, blogs, websites and social media;
- Advertisements disseminated to pooled investment vehicle investors (with an exception for RICs and BDCs) would explicitly be included; and
- The definition would no longer be qualified by the "more than one person" element.

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3 The Current Advertising Rule defines "advertisement" to include "any notice, circular, letter or other written communication addressed to more than one person, or any notice or other announcement in any publication or by radio or television, which offers (1) any analysis, report, or publication concerning securities, or which is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (2) any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell, or (3) any other investment advisory service with regard to securities."

Third-Party Communications

Under the Proposed Advertising Rule, in some cases an adviser could be responsible for communications by third parties "by or on behalf of an investment adviser." Thus, for example, advertisements provided by advisers to intermediaries (*e.g.*, consultants and solicitors) for dissemination would be captured, as would communications by an adviser's affiliates respecting the adviser's products and services. The SEC indicated in the proposing release that the "on behalf of" element would require affirmative steps by the adviser that would establish that materials disseminated without the adviser's authorization would not be "by or on behalf of" the adviser. In contrast, unaffiliated third-party content could be considered to be "by or on behalf of" an adviser if the adviser has involved itself in preparing the content or has otherwise endorsed or approved (explicitly or implicitly) the content.[4] This element of the Proposed Advertising Rule may be particularly relevant in marketing through the Internet and social media, where an adviser may link to third-party content or permit comment posting. The chart below summarizes the SEC's guidance regarding third-party content, which the SEC noted is a facts-and-circumstances analysis turning on the extent to which the adviser involves itself in the presentation:

Third-party content could be "by or on behalf of" the adviser if the adviser:	**Third-party content generally would not be "by or on behalf of" the adviser if the adviser:**
• Drafts, submits or is otherwise involved substantively in content preparation • Exercises ability to influence or control the content (*e.g.*, editing, suppressing, organizing or prioritizing the presentation of the content) • Pays for the content (including by non-cash compensation) • Permits third parties to post public commentary to adviser's website or social media page ***but selectively deletes or alters comments or sorts third-party content in a manner favorable to the adviser***	• Links to third-party content in a press release, without more, provided that the third party drafted the linked content and is free to modify it[5] • Takes no affirmative steps to influence the content of reviews or posts, where content concerning the adviser is hosted on a third-party platform and users are invited to post reviews or other information • Permits third parties to post public commentary to the adviser's website or social media page, without more • Permits the use of "like," "share" or "endorse" features on a third-party website or social media platform, without more

4 The "by or on behalf of" element of the Proposed Advertising Rule appears to be an attempt to codify the "adoption" and "entanglement" doctrines previously articulated less formally by the Staff, and captures and generalizes many of the principles expressed in the Division of Investment Management's Guidance on the Testimonial Rule and Social Media, published by the Staff in 2014.

5 If the adviser knows or has reason to know that the linked content contains an untrue statement of material fact or materially misleading information, the SEC would consider the link to be fraudulent or deceptive under Section 206.

Promotional and Educational Materials

Defining "advertisement" to include communications that "offer or promote" the adviser's services is intended (among other things) to clarify that promotional materials, whether or not they explicitly offer services, are within the scope of the rule, while continuing to allow advisers to deliver account statements and transaction reports (that provide only details regarding the accounts and investments) to existing investors without triggering application of the rule. This feature of the proposed definition also would permit general educational materials concerning investing or the markets to be utilized without triggering application of the rule. Whether specific statements, reports or educational materials might be considered to "offer or promote" the adviser's services would be a facts-and-circumstances determination. However, an interesting example can be found in the Proposal's discussion of performance advertising: educational performance presentations showing asset allocation by type or class generally would not be considered "backtested" performance within the Proposed Advertising Rule's definition of hypothetical performance.

Investors in Pooled Investment Vehicles

The proposed definition would include communications provided to existing and prospective investors in a pooled investment vehicle advised by the adviser, subject to the noted exclusions for certain RIC and BDC materials.[6] The SEC indicated that this change would supplement Rule 206(4)-8 by providing "more specificity ... regarding what we believe to be false or misleading statements that advisers to pooled investment vehicles must avoid in their advertisements."[7]

Specific Exclusions from the Definition of "Advertisement"

The chart below summarizes specific exclusions from the definition.

Exclusion	Discussion
Live, Non-Broadcasted Oral Communications	• Not available if communications are "widely disseminated." • Online public Q&A sessions would be advertisements, but online Q&A sessions available "only to one person or a small group of people invited by the adviser" would not. • Pre-recorded messages would not fall within the exclusion. • Prepared written materials intended for use during, or distributed as part of, a live oral communication (*e.g.*, script, storyboard, slides, other written materials) would not fall within the exclusion.

6 For purposes of the Proposed Advertising Rule, "pooled investment vehicle" would include (i) any investment company and (ii) any private fund (*i.e.*, a fund relying on Section 3(c)(1) or Section 3(c)(7) of the Investment Company Act of 1940, as amended). Proposed Advertising Rule 206(4)-1(e)(9); *see also* Advisers Act Rule 206(4)-8(b).

7 Rule 206(4)-8 applies general anti-fraud and disclosure protections to investors and prospective investors in pooled investment vehicles (including RICs and BDCs, as well as private funds). The SEC requested comment on whether Rule 206(4)-8 should be amended.

Exclusion	Discussion
Responses to Unsolicited Requests for Information	• Would not be available for: – Any communication to a retail person that includes performance results; or – Any communication that includes hypothetical performance.[8] • The communication must not go beyond the requested information. • Any information beyond the specific request would not fall within the exclusion (unless necessary to make the requested information not misleading).
RIC and BDC Materials	• The exclusion would apply only to materials covered by Rule 482 or Rule 156 under the Securities Act.
Information Required by Statute or Regulation	• Any information included that is beyond that required would not fall within the exclusion.

The SEC has requested comment on each aspect of the proposed definition of "advertisement."

General Prohibitions

The Proposed Advertising Rule would prohibit advertisements that:

- Include any untrue statement of material fact or make a material omission;
- Include an unsubstantiated material claim or statement;
- Include an untrue or misleading implication about, or are reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the adviser;
- Discuss or imply any potential benefit without clearly and prominently discussing any associated material risks or limitations;
- Include a reference to specific investment advice provided by the investment adviser that is not fair and balanced;
- Include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced; or
- Are otherwise materially misleading.

The SEC noted that a negligence standard, rather than a scienter standard, would apply to these prohibitions.

8 The terms "retail person" and "hypothetical performance" are discussed in more detail below.

Presenting "Specific Investment Advice" in a "Fair and Balanced" Manner – Proposed Updates to the Current General Prohibition on "Past Specific Recommendations"

Rather than imposing an effective prohibition on most materials that include "past specific recommendations" (as does the Current Advertising Rule), the Proposed Advertising Rule would employ a principles-based approach by requiring that such materials be presented in a manner that is fair and balanced. This would require a facts-and-circumstances determination, but advisers would have greater latitude to include information about past investments in advertisements. To assist advisers in considering whether materials would be "fair and balanced," the SEC noted that:

- Sufficient information and context to evaluate the merits of favorable or profitable specific investment advice would be necessary;
- Advisers should consider the nature and sophistication of the audience; and
- Selection criteria for providing a list of investment recommendations (*e.g.*, top holdings by value) and their application should produce fair and balanced results, and consistent application of such criteria limits the risk of presenting specific investment advice in an unfair manner.[9]

Performance Results

The Proposed Advertising Rule also would prohibit the inclusion or exclusion of performance results, or the presentation of performance time periods, in a manner that is not fair and balanced. As with the discussion of "specific investment advice," what would constitute a "fair and balanced" presentation of performance results would require a facts-and-circumstances determination. The SEC indicated that the following could constitute unfair or unbalanced performance result presentations: (i) presenting performance results over very short or inconsistent periods of time; and (ii) presenting performance results that fail to (a) include sufficient information to assess how the results were determined or (b) provide sufficient context to evaluate the results' utility.[10]

Testimonials, Endorsements and Third-Party Ratings

Definition of Testimonial, Endorsement and Third-Party Ratings

The Current Advertising Rule generally prohibits the use of testimonials, but does not define "testimonials" or elaborate on the types of communications that qualify as testimonials, leaving this to a thicket of Staff guidance. The Current Advertising Rule also does not explicitly address endorsements or third-party ratings (although the Staff previously provided guidance on the latter topic).

Acknowledging the widespread use of testimonials, endorsements and third-party ratings in today's marketplace generally, the SEC proposed to replace the current prohibition on the use of testimonials in adviser advertising with a more principles-based approach, under which advisers would be able to use testimonials, endorsements and third-

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9 The SEC noted that the requirements for presenting performance-based past specific recommendations set forth in *Franklin Management, Inc.* (pub. avail Dec. 10, 1998) could be helpful guidance. The SEC also noted that, while not required under the Proposed Advertising Rule, an adviser choosing to furnish a list of all recommendations within the immediately preceding period of not less than one year consistent with the Current Advertising Rule would meet the "fair and balanced" standard. *See* Current Advertising Rule 206(4)-1(a)(2).

10 Additional proposed requirements for performance advertising are discussed in more detail below.

party ratings in Retail or Non-Retail Advertisements (defined below),[11] subject to the general prohibitions of advertising practices and with additional disclosures.[12]

The SEC indicated that the proposed definitions of "testimonial" and "endorsement" are intended to broadly cover, respectively, an investor's experience with an adviser and a non-investor's approval or recommendation of an adviser. The definitions of testimonial and endorsement would include, respectively, a client's or a third-party's statements about an adviser or its advisory affiliates,[13] but would not include statements made about an adviser's related persons (other than advisory affiliates).[14] The Proposed Advertising Rule defines a "third-party rating" as "a rating or ranking of an investment adviser provided by a person who is not a related person, as defined in the Form ADV Glossary of Terms, and such person provides such ratings or rankings in the ordinary course of its business." The SEC specifically requested comment regarding whether the proposed definition of third-party rating should include affiliated parties under certain circumstances, such as when the rating is "at arm's length and not designed to favor the affiliate."

Testimonials, endorsements and third-party ratings would only be subject to the Proposed Advertising Rule to the extent that they themselves are advertisements or appear within an advertisement. Whether a testimonial, endorsement or third-party rating would be an advertisement would require a facts-and-circumstances analysis focusing on whether the communication is "by or on behalf of" the adviser. The SEC offered the following examples of when possible "testimonials" or "endorsements" on websites or on social media would not be considered an advertisement:

- Reviews or statements posted on a third-party website or social media platform, unless the adviser influenced the posts or paid to promote or hide certain reviews.

- Statements or ratings posted by a third party on an adviser's website or social media page, unless the adviser took steps to influence the content.

The Proposal notes that the Proposed Advertising Rule's general prohibitions also would apply to statements of a third party in a testimonial, endorsement or third-party rating. As a result, the SEC noted that an adviser would not be able to include testimonials about its performance results, without additional disclosure, if the results would not reflect the typical experience of the adviser's clients; such statements could cause investors to infer that those results are typical. If a testimonial, endorsement or third-party rating would be an advertisement, an adviser would be expected

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11 The SEC requested comment as to whether Non-Retail Persons and Retail Persons (each as defined below) are similarly positioned to use information that would be provided in the disclosures that accompany advertisements with testimonials, endorsements or third-party ratings.

12 As an example of how the portions of the Proposed Advertising Rule that pertain to testimonials, endorsements and third-party ratings could be tailored to the needs of Retail as opposed to Non-Retail Persons, the SEC solicited comment as to whether, for testimonials included in Retail Advertisements, the rule text should expressly prohibit an adviser from selectively including positive testimonials without presenting an equal number of negative testimonials.

13 For purposes of the Proposed Advertising Rule, an adviser's "advisory affiliates" are "(1) [its] officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling or controlled by [the adviser]; and (3) all of [its] current employees (other than employees performing only clerical, administrative, support or similar functions)." The SEC requested comment on whether statements about an adviser's advisory affiliates should be considered testimonials or endorsements covered by the Proposed Advertising Rule.

14 For purposes of the Proposed Advertising Rule, an adviser's "related persons" are "[a]ny [of its] advisory affiliate[s] and any person that is under common control with [the adviser]."

to comply with all of the provisions of the Proposed Advertising Rule (*e.g.*, an adviser would not be able to cherry-pick favorable testimonials or include in an advertisement an endorsement that makes a material claim that is unsubstantiated.).

The Proposed Advertising Rule would permit advisers to compensate a third party for testimonials, endorsements and third-party ratings, if such compensation is disclosed.[15] The SEC also decided not to include a *de minimis* exception, because "investors should be made aware when advisers provide even a small amount of compensation."[16]

Conditions on Testimonials, Endorsements and Third-Party Ratings

The Proposed Advertising Rule would define, and impose conditions on, testimonials, endorsements and third-party ratings, as summarized below.

Type	Definition	Conditions
Testimonial	Any statement ***of a client's or investor's experience*** with the adviser or its advisory affiliates.	The adviser must clearly and prominently[17] disclose, or reasonably believe that the testimonial clearly and prominently discloses, that: • The testimonial is given by a client/investor; and • If applicable, cash or non-cash compensation has been provided by or on behalf of the adviser.
Endorsement	Any statement ***by a person other than a client or investor*** indicating approval, support or recommendation of the adviser or its advisory affiliates.	The adviser must clearly and prominently disclose, or reasonably believe that the endorsement clearly and prominently discloses, that: • The endorsement was given by a non-client or non-investor; and • If applicable, cash or non-cash compensation has been provided by or on behalf of the adviser.

15 Compensated testimonials and endorsements generally would be considered to be provided "by or on behalf of" an adviser, and would thus fall within scope of the Proposed Advertising Rule.

16 FINRA rules permit paid testimonials, but require disclosure if a broker-dealer pays more than $100 in value for the testimonial. FINRA Rule 2210(d)(6)(B)(iii). In contrast, the Proposed Advertising Rule does not propose a *de minimis* exception, although the SEC specifically requested comment on whether the Proposed Advertising Rule should include such an exception similar to the FINRA rule.

17 The SEC noted that the compensation disclosure must be "at least as prominent as the testimonial, endorsement, or third-party rating."

Type	Definition	Conditions
Third-Party Rating	Rating or ranking of an adviser provided by a person who is not a related person, and such person provides such ratings or rankings in the ordinary course of its business.	The adviser must reasonably believe[18] that any questionnaire or survey used to prepare the rating: • Is structured to make it equally easy for a participant to provide favorable and unfavorable responses; and • Is not designed or prepared to produce a predetermined result. The adviser must clearly and prominently disclose, or reasonably believe that the third-party rating clearly and prominently discloses: • The date on which the rating was given; • The period of time covered by the review; • The identity of the third party that created and tabulated the rating; and • If applicable, that cash or non-cash compensation has been provided by or on behalf of the adviser.[19]

The disclosure requirements for testimonials, endorsements and third-party ratings also would apply to those that appear on a third-party-hosted platform to the extent that they are "on behalf of" the adviser. If an investor can only access an advertisement on a third-party platform *through the adviser*, the adviser would be able to satisfy the disclosure requirements by including necessary disclosures clearly and prominently on a "pop-up" page when the investor links to the third-party site. Where investors can access advertisements on third-party platforms and the adviser cannot provide the required disclosures itself, the adviser would need to "form a reasonable belief that the third-party statement or rating includes the required clear and prominent disclosures."[20]

18 The Proposal states that advisers should develop policies and procedures to incorporate the "reasonable belief" provision into their compliance programs. The SEC stated that, for example, an adviser could maintain records of the third-party rating that contains the necessary disclosures.

19 The compensation requirement would apply both to the rating agency and any person participating in the rating.

20 This requirement raises significant questions as to how an adviser can form a "reasonable belief" that the testimonial, endorsement or third-party rating includes the necessary disclosures. As a result, the SEC requested comment on whether the "reasonable belief" requirement should be retained, and in what types of situations it should apply.

Performance Advertising

Under the Proposed Advertising Rule, advertisements containing performance results (performance advertising) would be subject to: certain rules for all advertisements; and additional rules for Retail Advertisements (defined below).

Fundamentals of Proposed Rules for Performance Advertisements[21]

- **For all advertisements:**
  - An advertisement containing ***gross performance*** would be required to provide, or offer to provide promptly, a schedule of the specific fees and expenses (expressed in percentage terms)[22] deducted to calculate ***net performance***.
  - No performance advertisement could include any statement, express or implied, that the calculation or presentation of performance results has been approved or reviewed by the SEC.
  - An advertisement containing ***related performance*** would be required to include all ***related portfolios***, unless:
    - The advertised results are no higher than if all related portfolios had been included; and
    - The exclusion of any related portfolio does not alter the presentation of certain prescribed time periods.
  - An advertisement containing ***extracted performance*** would be required to provide, or offer to provide promptly, the performance results of all investments in the ***portfolio*** from which it was extracted.
  - ***Hypothetical performance*** would be permitted only if the adviser:
    - Adopts and implements policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the financial situation and investment objectives of the recipient(s);[23]
    - Provides sufficient information to enable such person to understand the criteria used and assumptions made in calculating such hypothetical performance; and

21 Highlighted terms in this summary are defined in the "Key Definitions" insert.

22 That is, as a percentage of assets under management.

23 The SEC indicated that hypothetical performance should be provided only to recipients that have sufficient financial and analytical resources to assess the hypothetical performance. However, the Proposal made clear that an adviser's policies and procedures would not be required to involve inquiring into each recipient's specific financial situation or investment objectives; rather, policies and procedures could identify characteristics of investors for whom the adviser believes hypothetical performance is relevant and a description of the adviser's basis for such belief. Nonetheless, advisers should give "closer scrutiny" to the relevance of hypothetical performance to investors that do not have access to analytical and other resources to enable them to analyze the hypothetical performance and underlying calculation and risk information.

Fundamentals of Proposed Rules for Performance Advertisements[21]

- Provides (or, if such person is a ***non-retail person***, provides or offers to provide promptly) sufficient information to enable such person to understand the risks and limitations of using such hypothetical performance in making investment decisions.

- For Retail Advertisements:
  - An advertisement containing ***gross performance*** would be required to also present ***net performance***:
    - With at least equal prominence to, and in a format designed to facilitate comparison with, the gross performance; and
    - Calculated over the same time period, and using the same type of return and methodology as, the gross performance.
  - Performance for certain prescribed time periods must be presented in each advertisement that includes performance results of any ***portfolio*** or composite of ***related portfolios***. This requires Retail Advertisements to include 1-, 5-, and 10-year performance periods, presented with equal prominence and ending on the most recent practicable date.[24] If the relevant portfolio did not exist for a particular prescribed period, performance since inception is required.[25]

Key Definitions for Performance Advertising under Proposal

- ***Extracted Performance***: The performance results of a subset of investments extracted from a portfolio.
- ***Gross Performance***: The performance results of a portfolio before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio.
- ***Hypothetical Performance***: Performance results that were not actually achieved by any portfolio of any client of the investment adviser, including, without limitation:
  - Performance derived from representative model portfolios that are managed contemporaneously alongside portfolios managed for actual clients;

24 The SEC noted further that disclosure concerning "whether more recent performance results for the same portfolio are available" should be included to avoid an advertisement containing performance results from being "reasonably likely to cause an untrue or misleading inference to be drawn concerning the adviser's performance," in violation of the Proposed Advertising Rule's general prohibition.

25 Subject to the general requirements, additional periods also could be presented.

Key Definitions for Performance Advertising under Proposal

- Performance that is backtested by the application of a strategy to market data from prior periods when the strategy was not actually used during those periods;[26] and
- Targeted or projected performance returns with respect to any portfolio or to the investment services offered or promoted in the advertisement.[27]

- ***Net Performance***: The performance results of a portfolio after the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio, including, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the investment adviser.[28]

- ***Non-Retail Advertisement***: Any advertisement for which an investment adviser has adopted and implemented policies and procedures reasonably designed to ensure that the advertisement is disseminated solely to Non-Retail Persons.

- ***Non-Retail Person***: One or more of:
  - A "qualified purchaser" as defined in Section 2(a)(51) of the Investment Company Act of 1940, taking into account Rule 2a51-1 thereunder.
  - A "knowledgeable employee" as defined in Rule 3c-5 under the 1940 Act with respect to a company that would be an investment company but for the exclusion provided by Section 3(c)(7) of the 1940 Act and that is advised by the adviser (a 3(c)(7) Company).

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26 Educational performance presentations showing asset allocation by type or class generally would not be considered "backtested" performance within the Proposed Advertising Rule's definition of hypothetical performance. The SEC provided an example of this point, noting that a presentation comparing how portfolios with various allocations to equities and bonds would have performed over the past 50 years would not be prohibited under the Proposed Advertising Rule, even if the adviser used one of the allocations in managing a strategy being advertised, or if the adviser illustrated the allocations by reference to indices or benchmarks.

27 Any type of performance presented as results that could be, are likely to be, or may be achieved in the future by the investment adviser would be considered a target or projection. These terms are not formally defined in the Proposed Advertising Rule.

Projections for general market performance or economic conditions would not be considered targets or projections constituting hypothetical performance. Interactive financial analysis tools that do not project returns of a portfolio forward would not be considered targeted or projected performance returns, and interactive tools allowing investors to select their own targeted or assumed rate of return to project forward a portfolio's return would not be considered targeted or projected performance returns. If such a tool provided anticipated returns for the strategy or portfolio, the tool would be considered to provide targeted or projected performance results.

28 For purposes of the Proposed Advertising Rule, net performance may reflect one or more of: (i) the deduction of a model fee when doing so would result in performance figures that are no higher than if the actual fee had been deducted; (ii) the deduction of a model fee that is equal to the highest fee charged to the relevant audience of the advertisement; and (iii) the exclusion of custodian fees paid to a bank or other third-party organization for safekeeping funds and securities.

Key Definitions for Performance Advertising under Proposal

- ***Portfolio***: A group of investments managed by the investment adviser; a portfolio may be an account or a pooled investment vehicle.
- ***Related Performance***: The performance results of one or more related portfolios, either on a portfolio-by-portfolio basis or as one or more composite aggregations of all portfolios falling within stated criteria.
- ***Related Portfolio***: A portfolio with substantially similar investment policies, objectives, and strategies as those of the services being offered or promoted in the advertisement;[29] this term includes, but is not limited to, a portfolio for the account of the investment adviser or its advisory affiliate.[30]
- ***Retail Advertisement***: Any advertisement other than a Non-Retail Advertisement.
- ***Retail Person***: Any person other than a Non-Retail Person.

Application of General Prohibitions to Performance Advertising

As discussed above, the Proposed Advertising Rule includes a number of general prohibitions designed to prevent advertisements that are false or misleading. The SEC acknowledged that many investment advisers already include in performance advertising disclosures intended to avoid the types of omissions, implications and inferences that would be addressed by these general prohibitions, many of which have been discussed in guidance from the SEC's Staff.[31] The Proposed Advertising Rule would not explicitly require that these, or any other, specific disclosures or legends be included in performance advertising; rather, the Proposed Advertising Rule takes a more principles-based approach under which advisers would need to evaluate the particular facts and circumstances (including, for example, the assumptions, factors and conditions that contributed to the advertised performance) to determine what disclosures or other information would be needed.

Retail v. Non-Retail Distinction

Under the Proposed Advertising Rule, Retail Advertisements and Non-Retail Advertisements would be treated differently.[32] This approach, coupled with the Proposed Advertising Rule's application to "any communication ... that offers or promotes the investment adviser's investment advisory services or that seeks to obtain or retain one or more

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29 According to the SEC, the same criteria used to construct composites for purposes of the Global Investment Performance Standards could be used in satisfaction of this "substantially similar" standard. The Proposed Advertising Rule does not further prescribe specific standards or requirements for determining whether portfolios are "related."

30 Portfolios for the account of the investment adviser or its advisory affiliates are often subject to lower (or no) fees and expenses than are otherwise offered. The SEC stated that, in such a case, satisfying the "net performance" requirement generally would require an adviser to apply the fees and expenses that an unaffiliated client would have paid.

31 *See, e.g.*, *Clover Capital Mgmt.* (pub. avail. Oct. 28, 1986).

32 The SEC sought comment on an extensive list of issues related to the retail versus non-retail distinction in the Proposed Advertising Rule's treatment of performance advertising.

investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser," means that, among other requirements:

- An adviser disseminating marketing materials concerning a pooled investment vehicle would be required to "look through" the vehicle to determine whether investors are Retail Persons or Non-Retail Persons;[33] and

- Advisers seeking to disseminate Non-Retail Advertisements would need to ensure that they have adopted and implemented policies and procedures reasonably designed to ensure that such advertisements are disseminated solely to Non-Retail Persons.[34]

Portability of Performance, Testimonials, Third-Party Ratings and Specific Investment Advice

Advisers frequently seek to advertise information, performance results, testimonials, endorsements or third-party ratings of advisory services rendered by a predecessor firm, a firm acquired by the adviser or the adviser's personnel while at a prior employer. Although often such information would be able to be presented consistently with the Proposed Advertising Rule, the Proposed Advertising Rule would neither explicitly permit nor prohibit or limit such presentations based solely upon their relation to a predecessor firm. Rather, the SEC offered examples of scenarios where "ported" information could be false or misleading. In particular, consistent with Staff guidance under the Current Advertising Rule, predecessor performance could be misleading if the team that was primarily responsible for the predecessor performance was different from the team that will provide the advisory services offered in the advertisement.[35]

The Proposal generally discusses the use of such "predecessor performance results" in advertisements, although the Proposed Advertising Rule does not currently include any specific provisions regarding the use of predecessor performance results. Rather, as proposed, advertisements that include predecessor performance would be subject to the general requirements of the Proposed Advertising Rule and relevant specific provisions of the Proposed Advertising Rule related to performance advertising.[36]

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33 The SEC noted that, where a pooled investment vehicle has both Retail Person and Non-Retail Person investors, the adviser could disseminate Retail Advertisements to the vehicle's Retail Person investors and Non-Retail Advertisements to the vehicle's Non-Retail Person investors or, alternatively, use only Retail Advertisements.

34 Although the Proposed Advertising Rule would not prescribe specific provisions or requirements for such policies and procedures, the SEC indicated that the adviser's procedures might: (i) base the determination of Non-Retail Person status on the adviser's knowledge of the amount of the investor's "investments" managed by the adviser; (ii) take into account any existing policies and procedures related to 1940 Act Rule 2a51-1 relating to the definition of "qualified purchaser;" or (iii) reflect the adviser's ability to determine which employees are "knowledgeable employees" of a 3(c)(7) Company advised by the adviser.

35 The term "predecessor performance results" includes situations where an investment adviser presents investment performance achieved by a portfolio that was not advised at all times during the period shown by the investment adviser. The SEC noted that none of the following, alone, would render the adviser's past performance "predecessor performance": (i) a change of the adviser's brand name; (ii) change in ownership of the adviser; or (iii) change in structure or form of the organization. *See also, Bramwell Growth Fund* (pub. avail. Aug. 7, 1996).

36 The SEC requested comment on whether the Proposed Advertising Rule should include provisions that specifically address the presentation of predecessor performance results. The SEC also stated that it is considering how requirements under the Current Recordkeeping Rule would apply to portability of performance, and the SEC requested comment on whether the Current Recordkeeping Rule should be amended to address with specificity the substantiation of predecessor performance.

The SEC also noted that the same framework that advisers would be expected to apply when determining how predecessor performance could be used under the Proposed Advertising Rule likely also would apply to analyzing how predecessor testimonials, endorsements, third-party ratings or specific investment advice could be used in an adviser's advertisements.[37]

Review and Approval of Advertisements

In a significant departure from the Current Advertising Rule, the Proposed Advertising Rule would require that one or more designated employees of the adviser review and approve each new advertisement prior to its dissemination (Pre-Approval Requirement).[38] The Proposed Advertising Rule would provide reasonable flexibility as to which personnel would be designated to fulfill the Pre-Approval Requirement. However, these designated individuals would be expected to be "competent and knowledgeable regarding the proposed rule's requirements" and, in the SEC's view, generally ***should*** include an adviser's legal or compliance personnel. Moreover, the SEC indicated that the person who creates an advertisement generally should not be responsible for fulfilling the Pre-Approval Requirement for that advertisement.[39] One-on-one communications and live oral communications would be excluded from the Pre-Approval Requirement but would still be subject to all other applicable requirements of the Proposed Advertising Rule.

- **One-on-One Communications:** Communications disseminated to a single person (which includes a natural person or a company) or single household would not be subject to the Pre-Approval Requirement. However, merely customizing a template presentation or mass mailing by adding the name of an individual investor or other basic information would not be a one-on-one communication, as such activities would be viewed by the SEC as a "customized mass mailing."

- **Live Oral Broadcasts:** Because the nature of live broadcasts makes prior review impossible, the Proposed Advertising Rule also excludes live oral communications that are broadcast on radio, television, the Internet or any similar medium (collectively, live broadcasts) from the Pre-Approval Requirement. However, the SEC noted that any written script or prepared materials (*e.g.*, slides) used in or with a live broadcast would be subject to the Pre-Approval Requirement. Additionally, if a live broadcast is recorded and the recording is distributed by or on behalf of the adviser, then the recording of the broadcast would also be subject to the Pre-Approval Requirement. [40]

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37 The SEC specifically requested comment on whether the Proposal should include specific provisions or require specific disclosures in order to present testimonials, endorsements, third-party ratings or investment advice applicable to a predecessor entity. The SEC also requested comment on whether it is feasible for advisers to maintain books and records to substantiate the applicability and relevance of testimonials, endorsements, third-party ratings and specific investment advice from a predecessor entity.

38 The SEC requested comment on whether it should permit outside parties (*e.g.*, law firms, compliance consultants) to conduct the reviews and whether the review and approval process should differ based on the anticipated audience.

39 The SEC noted that most advisers currently review broadly disseminated communications but could need to revise their policies and procedures to include such other communications that would qualify as advertisements.

40 It may be expected that an ordinary re-run would not be considered a communication "by or on behalf of the adviser." However, if a broadcast was unable to pass muster under the Pre-Approval Requirement, an adviser would be unable to re-disseminate the broadcast nor could anyone else re-disseminate it on the adviser's behalf (absent editing, if permitted).

Related Proposed Revisions to Form ADV

Form ADV does not currently require disclosure of an adviser's advertising practices. To provide relevant information to the Staff, the SEC proposed to amend Item 5 of Form ADV, Part 1A by adding a new subsection L, which would require advisers to disclose information about their use of performance results, testimonials, endorsements, third-party ratings and previous investment advice in advertisements.[41]

Recordkeeping

The SEC proposed the following amendments to the Current Recordkeeping Rule in connection with the Proposed Advertising Rule.

Topic	Proposed Recordkeeping Rule	Current Recordkeeping Rule
Advertisements in General	Advisers would be required to retain records of all advertisements sent to one or more persons.[42]	Advisers generally must retain records of advertisements sent to 10 or more persons.
Third-Party Ratings	Advisers that use third-party ratings in an advertisement would be required to retain a record of any questionnaire or survey used to create the third-party rating.[43]	N/A
Pre-Approval Requirement	Advisers would be required to maintain a copy of all written approvals of advertisements by designated employees.	N/A

41 The SEC requested comment on whether Form ADV should be further amended to require advisers to: indicate to whom they direct specific advertisements (*e.g.*, Retail or Non-Retail Persons); disclose that they provide hypothetical performance; state whether they use predecessor performance and affirm that the other advisory firm permits the adviser's use of performance results; and describe their advertising practices in Form ADV, Part 2A.

42 These recordkeeping requirements would not apply to live oral communications that are not broadcast, but would apply to hypothetical performance information (as well as any supplemental accompanying information).

43 This requirement would apply to any questionnaire or survey the adviser completes for the third party and any "form of" questionnaire or survey the third party sends to the adviser's investors or other survey participants.

Topic	Proposed Recordkeeping Rule	Current Recordkeeping Rule
Performance Advertisements	Advisers would be required to make and keep originals of all written communications received and copies of all written communications sent by the adviser relating to the performance or rate of return of any or all ***managed accounts, portfolios (as defined in Rule 206(4)-1(e)(10)) or securities recommendations***. Advisers also would be required to continue to comply with the current recordkeeping requirement with respect to the calculation of performance or rate of return (described to the right) of any or all ***portfolios*** and any information provided or offered in connection with the hypothetical performance provisions of the Proposed Advertising Rule.	Advisers must make and keep originals of all written communications received and copies of all written communications sent by the adviser relating to the performance or rate of return of any or all ***managed accounts or securities recommendations***. Advisers must retain all accounts, books, internal working papers and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all ***managed accounts or securities recommendations***.

Proposed Amendments to the Solicitation Rule

The SEC proposed a number of revisions to the Current Solicitation Rule, which generally allows investment advisers registered or required to be registered with the SEC to pay cash fees to solicitors for solicitation activities provided that certain conditions are met. While the proposed changes to the Current Solicitation Rule would not be as dramatic as those relating to advertising described above, the Proposal still represents a serious effort to modernize the Solicitation Rule and bring it into the 21st century. Key changes are summarized below.

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Solicitors/Solicitation	Any person who, directly or indirectly, solicits any client or private fund investor (Prospect) for, or refers any Prospect to, an investment adviser.	• Consistent with the Current Solicitation Rule, a solicitor may be a firm (*e.g.*, broker-dealer, adviser or bank) or an individual. • The Proposed Solicitation Rule would apply to persons who solicit investors for an adviser's private funds, expanding the scope of current rule by effectively rescinding the *Mayer Brown* no-action letter.[44] • In some cases, the Proposed Solicitation Rule could apply to a person providing compensated testimonials or endorsements.[45]
Compensation	The Proposed Solicitation Rule would apply where a covered adviser pays direct or indirect compensation[46] to a solicitor for any solicitation activities.	• Consistent with the Current Solicitation Rule, the Proposed Solicitation Rule would include cash payments (*e.g.*, percentage of assets under management, flat fees, retainers or hourly fees). • Unlike the Current Solicitation Rule, the Proposed Solicitation Rule also would apply to non-cash compensation.[47]

44 *See Mayer Brown LLP* (pub. avail. July 15, 2008). "Private fund" here would be defined consistent with Section 202(a)(29): an issuer that would be an investment company, as defined in Section 3(a) of the 1940 Act, but for Section 3(c)(1) or 3(c)(7) of the 1940 Act.

45 The SEC noted that receipt by such person of incentive-based compensation (*e.g.*, payment per referral) and greater control by such person over the communication would each make it more likely that the person is a solicitor.

46 Indirect compensation would include (among other things) circumstances where: (i) an individual solicits an investor and the adviser compensates another person for such solicitation (such as an employer or other entity associated with the individual); and (ii) a solicitor refers investors to advisers that recommend the solicitor's or its affiliate's proprietary investment products or recommend products that have revenue sharing or other pecuniary arrangements with the solicitor or its affiliate.

47 For example, directing client brokerage to brokers that refer investors, sales awards, training or education meetings (if provided in exchange for solicitation activities), outings, tours, other forms of entertainment, free or discounted advisory services and investment advice directly or indirectly benefitting the solicitor. Broker-dealers and dual registrants receiving brokerage for solicitation of client accounts in wrap fee programs they do not sponsor would be captured if they solicit those clients to participate in the wrap fee program. Additionally, compensating or providing rebates or other incentives such as subscriptions or gift cards to current investors to solicit other investors ("refer-a-friend" arrangements) could involve non-cash compensation within the scope of the Proposed Solicitation Rule. The *de minimis* exemption may exempt certain such arrangements.

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Registration Status	The Proposed Solicitation Rule would apply to an adviser registered or required to be registered with the SEC.	• The Proposed Solicitation Rule would eliminate the requirement under the Current Solicitation Rule that an adviser that is required to be registered must in fact be registered in order to compensate a solicitor.
Disclosure by or about Third-Party Solicitors	Either the solicitor or the adviser (as agreed between the parties) would be required to provide the Prospect, at time of solicitation activities (or as soon as reasonably practicable thereafter in the case of a mass communication[48]), a separate disclosure statement with specified information concerning the arrangement.	• This portion of the Proposed Solicitation Rule is derived from the Current Solicitation Rule's written disclosure statement requirement. • In contrast to the Current Solicitation Rule (which requires the solicitor to deliver the disclosure), either the solicitor or the adviser would be permitted to deliver the disclosure. • The Proposed Solicitation Rule would permit disclosure to be delivered in various ways, in any format, including orally.[49] • Consistent with the Current Solicitation Rule, disclosure must be "separate."[50] • The Proposed Solicitation Rule would not require Form ADV delivery (which would instead be left to Rule 204-3).

48 The SEC indicated that it would view providing the solicitor disclosure promptly after the Prospect expresses an initial interest in response to a mass solicitation to be "as soon as reasonably practicable" after a mass solicitation. In cases where the adviser has agreed to deliver the disclosure, the SEC indicated that "as soon as reasonably practicable thereafter" would be at the time the Prospect first reaches out in any manner to the adviser in response to a solicitation.

49 The Advisers Act recordkeeping requirements would continue to apply, so no matter the form, any disclosure would need to be capable of being retained. For example, oral disclosures would need to be recorded.

50 In this regard, the SEC stated in the Proposal that "separate, targeted disclosure of the salient terms of the compensated arrangement provided at the time of the solicitation, would draw the investor's attention to the solicitor's bias in recommending an adviser directly or indirectly compensating it for the referral. While advisers themselves are required to disclose to clients their compensation arrangements, including compensation for client referrals and the related conflicts of interest, we believe that the separate solicitor disclosure to investors would put investors on notice of the solicitor's conflict of interest in the compensated solicitation arrangement."

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Required Disclosure	For third-party solicitors, the disclosure would be required to include: • The adviser's name; • The solicitor's name; • A description of the adviser's relationship with the solicitor (*e.g.*, if the solicitor is an unaffiliated third party or a current client); • The terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor (directly or indirectly); • A description of any potential material conflicts of interest on the part of the solicitor resulting from the adviser's relationship with the solicitor and/or the compensation arrangement; and • The amount of any additional cost to the client or private fund investor as a result of the solicitation (which might include, for example, higher investment advisory fees for investors that are advisory clients). For in-house and affiliated solicitors (as described below), the nature of the affiliation between the solicitor and the advised would need to be disclosed at the time of solicitation unless it is readily apparent.	• The Proposed Solicitation Rule would add a new requirement to disclose any potential material conflicts of interest between the solicitor and a Prospect (as defined above) associated with the solicitation arrangement.

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Written Agreement	The adviser's compensation to a solicitor would need to be pursuant to a written agreement with the solicitor that: (i) describes with specificity the solicitation activities of the solicitor and the terms of the compensation for solicitation activities; (ii) requires the solicitor to perform its solicitation activities in accordance with the Advisers Act's anti-fraud provisions; and (iii) requires and designates either the solicitor or the adviser to provide Prospects with the required, separate disclosure (described above).	The Proposed Solicitation Rule would eliminate certain required elements of written agreements under the Current Solicitation Rule, including: • Brochure delivery; and • Undertaking to perform duties consistent with the adviser's instructions and the Advisers Act and rules thereunder.
Adviser Oversight and Compliance	The adviser would be required to have a reasonable basis for believing that the solicitor has complied with the written agreement.	This provision would replace the current requirement that the adviser make "a bona fide effort to ascertain whether the solicitor has complied with the [written] agreement, and [have] a reasonable basis for believing that the solicitor has so complied."
Client Acknowledgment	The Proposed Solicitation Rule would eliminate the Current Solicitation Rule's requirement that the adviser receive, prior to or at the time a client enters into an advisory contract with the adviser, the client's acknowledgment that the client received the adviser's brochure and the solicitor's written disclosure document.	The SEC indicated that although an acknowledgement would no longer be required, advisers might still elect to obtain one to evidence compliance with the written agreement.
Exemptions – Impersonal Investment Advice	Written agreement and oversight/compliance requirements would not apply to solicitations solely for impersonal investment advice.	• The Proposed Solicitation Rule would update the definition of "impersonal investment advice" to align with the Form ADV Glossary, but without impacting coverage. • As under the Current Solicitation Rule, the disqualification provisions (discussed below) would continue to apply.

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Exemptions – In-House and Affiliated Solicitors	Written agreement and oversight/compliance requirements would not apply if the solicitor is any of certain in-house personnel or personnel of affiliates;[51] provided that: (i) the affiliation between the adviser and the solicitor is readily apparent,[52] or is disclosed, to the client or private fund investor at time of the solicitation; and (ii) the adviser documents such solicitor's status at time the adviser enters into the solicitation arrangement.	• In contrast to the Current Solicitation Rule, the Proposed Solicitation Rule would not require explicit disclosure of the affiliation between the adviser and the solicitor if such affiliation is "readily apparent." • The Proposed Solicitation Rule explicitly expands the exemption to include persons that control, are controlled by or are under common control with the adviser. • It also eliminates the requirement under the Current Solicitation Rule for advisers and in-house/affiliated solicitors to enter into a simplified written agreement. • As under the Current Solicitation Rule, disqualification provisions (discussed below) continue to apply.

51 Specifically, the exemption would be available only if the solicitor is one of the adviser's partners, officers, directors or employees, or a person that controls, is controlled by, or is under common control with the adviser, or is a partner, officer, director or employee of such a person.

52 Such affiliation may be "readily apparent" where, for example, the in-house solicitor shares the same name as the adviser or clearly identifies itself as related to the adviser in its communications with the investor. Examples of circumstances where the affiliation is not "readily apparent" would include where the solicitor operates its solicitation activities through its own doing-business-as name or brand and the adviser's legal name is omitted or less prominent.

Topic	Summary of Proposed Rule	Observations on Selected Similarities to and Differences from Current Rule
Exemptions – *De Minimis* Compensation	None of the written agreement, oversight/compliance or disqualification provisions would apply if the solicitor has performed solicitation activities for the investment adviser during the preceding 12 months and the investment adviser's compensation payable to the solicitor for those solicitation activities is $100 or less (or the equivalent value in non-cash compensation).	• There is no similar provision in the Current Solicitation Rule. • The Proposed Advertising Rule's requirements for testimonials and endorsements may still apply even if the solicitation meets the *de minimis* exemption from the Proposed Solicitation Rule. • This provision of the Proposed Solicitation Rule is designed to reduce the burdens on "refer a friend" programs and social media-based solicitations. • The SEC cautioned an adviser to "carefully consider" eschewing the exemption if the adviser "expects to make payments ... in excess of the *de minimis* amount, even though it has not yet done so."
Exemptions – Nonprofit Programs	None of the written agreement, oversight/compliance or disqualification provisions would apply if: (i) the adviser has a reasonable basis for believing that (A) the solicitor is a nonprofit program, (B) participating investment advisers compensate the solicitor only for costs reasonably incurred in operating the program and (C) the solicitor provides clients a list of at least two advisers based on non-qualitative criteria; and (ii) the solicitor or the adviser prominently discloses certain information to client at the time of solicitation activities.	• There is no similar provision in the Current Solicitation Rule.

Disqualification Provisions

The Proposed Solicitation Rule would prohibit an investment adviser from compensating a solicitor, directly or indirectly, for any solicitation activity if the adviser knows, or, in the exercise of reasonable care, should have

known,[53] that the solicitor is an ineligible solicitor. An ineligible solicitor, as described in more detail in the following chart, is: (A) a person who at the time of the solicitation is subject to a ***disqualifying Commission action*** or is subject to any ***disqualifying event***; (B) any employee, officer, or director of an ineligible solicitor and any other individuals with similar status or functions; (C) in the case of a partnership being the ineligible solicitor, each general partner; (D) in the case of a limited liability company managed by elected managers being the ineligible solicitor, each elected manager; and (E) any person directly or indirectly controlling or controlled by the ineligible solicitor, as well as any person listed in (B) – (E) with respect to such person.[54] The Proposed Solicitation Rule also includes a conditional carve-out from the disqualification for certain types of SEC actions.[55] The various disqualifying provisions are summarized below.

Topic	Summary	Observations/Current Rule
Disqualifying Commission Action	An SEC opinion or order barring, suspending, or prohibiting the person from acting in any capacity under the Federal securities laws, or ordering the person to cease and desist from committing or causing a violation or future violation of: (1) any scienter-based anti-fraud provision of the Federal securities laws[56] or any other rule or regulation thereunder; or (2) Securities Act Section 5.	Compare this concept with the Current Solicitation Rule's disqualification for persons found by the SEC to have engaged in any of the conduct specified in Section 203(e)(1), (5) or (6).[57]

53 In comparison, the Current Solicitation Rule's disqualification provisions contain only an absolute bar (and no such reasonable care standard) on paying cash solicitation fees to persons with any of the disciplinary events enumerated in the rule in their history.

54 A firm would not necessarily be an ineligible solicitor if one or more of the listed persons are ineligible solicitors, so long as such persons do not conduct solicitation activities. However, as indicated by the enumerated list, a firm's status as an ineligible solicitor would result in its personnel enumerated in the list also being ineligible solicitors.

55 The Proposed Solicitation Rule's definition of disqualifying events does not include convictions, orders, judgments, or decrees by a foreign court or findings by foreign financial regulatory agencies. The SEC proposed to carve out foreign proceedings from the list of proposed disqualifying events due to the cost and burdens that would be imposed on advisers by requiring them to inquire into foreign proceedings with respect to their solicitors.

56 The Proposed Solicitation Rule would specify that scienter-based anti-fraud provisions include (without limitation): Section 206(1); Section 17(a) of the Securities Act; Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and Section 15(c)(1) of the Exchange Act.

57 Section 203(e)(1) concerns willfully making or causing to be made in any application for registration or report required to be filed with the SEC under the Advisers Act, or in any proceeding before the SEC with respect to registration, any statement that was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein. Section 203(e)(5) concerns willfully violating any provision of the Securities Act, the Exchange Act, the 1940 Act, the Advisers Act, the Commodity Exchange Act or the rules and regulations under any statutes or any rule of the Municipal Securities Rulemaking Board, or being unable to comply with any such provision. Section 203(e)(6) concerns willfully aiding and abetting the violations described in Section 203(e)(5), or failing reasonably to supervise a person who commits such a violation. The Current Solicitation Rule's disqualification provisions include, in addition to findings by the SEC, any conviction by a court of any of the foregoing.

Topic	Summary	Observations/Current Rule
Disqualifying Event	The Proposed Solicitation Rule includes each of the following events: • (1) A conviction by a court of competent jurisdiction in the United States, within the previous 10 years, of any felony or misdemeanor involving conduct described in Section 203(e)(2)(A)-(D).	The Current Solicitation Rule includes identical disqualification provisions, except that it does not limit convictions creating a disqualification to those in United States courts.
	• (2) A conviction by a court of competent jurisdiction in the United States, within the previous 10 years, of engaging in any of the conduct specified in Section 203(e)(1), (5), or (6).	The Current Solicitation Rule includes identical disqualification provisions, except that it: (i) does not limit convictions creating a disqualification to those in United States courts, and (ii) captures similar SEC findings.[58]
	• (3) Entry of any final order of: the U.S. Commodity Futures Trading Commission; a self-regulatory organization; a state securities commission (or any agency or officer performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or any agency or officer performing like functions); an appropriate Federal banking agency; or the National Credit Union Administration that: (i) bars such person from association with any entity regulated by such commission, authority, agency, organization, or officer, from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or (ii) constitutes a final order, entered within the previous 10 years, based on violations of any laws, regulations, or rules that prohibit fraudulent, manipulative, or deceptive conduct.	This disqualification provision is not reflected in the Current Solicitation Rule, but rather is derived from Section 203(e)(9).

58 The SEC noted that in many cases, conduct underlying a felony or misdemeanor would be captured as a disqualifying Commission action, described above.

Topic	Summary	Observations/Current Rule
	• (4) Entry of an order, judgment, or decree described in Section 203(e)(4) by any court of competent jurisdiction in the United States.	The Current Solicitation Rule includes identical disqualification provisions, except that the Current Solicitation Rule does not limit convictions creating a disqualification to those in United States courts.
Conditional Carve-Out	If an act or omission that is the subject of a disqualifying event for a person also is the subject of a non-disqualifying Commission action with respect to that person, such disqualifying event would be disregarded in determining whether the person is an ineligible solicitor.[59]	The Proposed Solicitation Rule's conditional carve-out and its conditions are akin to those in existing SEC Staff guidance.[60]

To the extent the Proposed Solicitation Rule would expand a disqualification as compared with the Current Solicitation Rule, the expanded disqualification would apply only to any disqualifying Commission action or disqualifying event occurring after the effective date (or compliance date, as applicable) of the Proposed Solicitation Rule, but disqualifying Commission actions or disqualifying events occurring prior to such date would be subject to the Current Solicitation Rule's disqualification provision.[61]

Related Proposed Revisions to Form ADV

As information regarding an adviser's use of solicitors and marketers for private funds already is required to be disclosed in response to various Items and Sections of Form ADV, no further amendments were proposed to require additional disclosures in connection with the Proposed Solicitation Rule.[62]

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59 A "non-disqualifying Commission action" is: (i) a Section 9(c) order under the 1940 Act; or (ii) an SEC opinion or order that is not a disqualifying SEC action. However, to avail oneself of the carve out, the person would be required to: (i) 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 fines; and (ii) for a period of 10 years following the date of each relevant opinion or order, include a description of the acts or omissions that are the subject of, and the terms of, the opinion or order in the solicitor's disclosure.

60 *See Dougherty & Company LLC* (pub. avail. July 3, 2003).

61 Currently, a number of advisers and solicitors rely on SEC Staff no-action letters allowing continued payment of cash solicitation fees to a solicitor subject to a disqualification provision under the Current Solicitation Rule. The SEC requested comment on whether such persons should be "grandfathered" into compliance with the Proposed Solicitation Rule. The SEC also noted that the Staff of the Division of Investment Management is reviewing certain such letters for withdrawal.

62 The SEC requested comment on whether Form ADV should be further amended to require advisers to include the names of, and other specified information about, current solicitors similar to the current requirement for disclosure of private fund marketers.

Recordkeeping

The SEC proposed the following amendments to the Current Recordkeeping Rule in connection with the Proposed Solicitation Rule.

Topic	Proposed Recordkeeping Rule	Current Recordkeeping Rule
Acknowledgments and Disclosure Documents	The SEC proposed to remove the requirement to retain written acknowledgments from the client; however, an adviser may still choose to receive such acknowledgments to inform its belief that the solicitor has satisfied the terms of the written agreement. In this circumstance, the adviser would retain a record of the acknowledgments. An adviser would be required to retain copies of solicitor disclosures delivered to clients and private fund investors. If the adviser participates in a nonprofit program, the adviser would be required to retain copies of all receipts of reimbursement of payments or other compensation the adviser provides relating to the program.	Advisers must retain all written acknowledgments from clients, that the client received: (i) the adviser's written disclosure statement and (ii) the solicitor's written disclosure document. Advisers also must retain copies of disclosure documents delivered to clients by solicitors.
Reasonable Basis Belief as to Solicitor's Compliance with Contract	An adviser would be required to retain any communication or other document related to the adviser's reasonable-basis belief determination that any solicitor it compensates under the Proposed Solicitation Rule has complied with the written agreement requirement in the Proposed Solicitation Rule and is "not an ineligible solicitor." An adviser would be required to retain copies of all receipts for reimbursements or other compensation paid in connection with its inclusion in the nonprofit program.	N/A

Topic	Proposed Recordkeeping Rule	Current Recordkeeping Rule
List of Affiliates	An adviser would be required to retain a record of the names of all solicitors who are partners, officers, directors, employees or other affiliates of the adviser.	N/A
Nonprofit Programs	An adviser would be required to retain any communication or other document related to the adviser's reasonable-basis belief determination that any nonprofit program in which the adviser participates meets the requirements of the Proposed Solicitation Rule. An adviser would be required to retain copies of all receipts for reimbursements or other compensation paid in connection with its inclusion in the nonprofit program.	N/A

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