

Joseph H. Nesler



January 15, 2020

Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

Attention: Vanessa A. Countryman, Secretary

Re: File Number S7-21-19

Ladies and Gentlemen

I thank you for the opportunity to comment on SEC Release No. IA-5407 (November 4, 2019) (the “Proposing Release”), in which the Securities and Exchange Commission (“SEC” or the “Commission”) proposed certain amendments to: (i) Rule 206(4)-1 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”) and (ii) Rule 206(4)-3 under the Advisers Act. The comments set forth below relate primarily to the proposed amendments to Rule 206(4)-3. I may submit additional comments on the proposed amendments to Rule 206(4)-1 by way of a separate comment letter.

For purposes of my comments, I refer to current Rule 206(4)-3 as the “Cash Solicitation Rule,” and to Rule 206(4)-3 in the form in which it is proposed to be amended in the Proposing Release as the “Proposed Revised Solicitation Rule.”

References below to page numbers of the Proposing Release are to the page numbers of the PDF form of the Proposing Release posted on the SEC’s website under “Regulations/Proposed Rule,” which you can find [here](#).

The comments set forth below are my own and do not necessarily reflect the views of my firm, any member of my firm or any client of my firm.

For purposes of convenience, I use the term “client” below to include both: (i) a “client,” as defined in paragraph (c)(1) of the Proposed Revised Solicitation Rule and (ii) a “private fund investor,” as defined in paragraph (c)(3) of the Proposed Revised Solicitation Rule.

**Comment Number 1:**

***The Commission should not withdraw its current position on the treatment of a solicitor as an “associated person” of an SEC-registered adviser where such adviser exercises control and supervision over such solicitor in connection with the solicitor’s performance of solicitation activities on behalf of such adviser.***

Footnote 346 of the Proposing Release observes (correctly) that, “[d]epending on the facts and circumstances, a person providing advice as to the selection or retention of an investment adviser may be an ‘investment adviser’ within the meaning of section 202(a)(11) of the Act and may also have an obligation to register under the Act.”

In the sentence of footnote 346 immediately following the sentence quoted above, the Proposing Release concludes that “[a]ccordingly, we are proposing to no longer take the position, as in 1979 when the Commission adopted the rule, that ‘a solicitor who engages in solicitation activities in accordance with paragraph (a)(2)(iii) of the rule ... will be, at least with respect to those activities, an associated person of an investment adviser and therefore will not be required to register individually under the Advisers Act solely as a result of those activities.’” (the “1979 Position”).

It is not clear how this conclusion follows from the premise. It is true that, depending on the facts and circumstances, a person providing advice as to the selection or retention of an investment adviser may be an “investment adviser” within the meaning of Section 202(a)(11) of the Act and may also have an obligation to register under the Act. But this was true in 1979 when the SEC adopted the 1979 Position, and there has been no change in the law that would render the 1979 Position invalid. Accordingly, it is unclear why the Commission wishes to withdraw the 1979 Position at this time.

Further, it is difficult to understand why a non-employee (e.g., independent contractor) solicitor should be treated any differently from an employee of an SEC-registered adviser who engages in solicitation activities on behalf of such adviser, as long as such non-employee solicitor is under the control and supervision of the adviser in connection with his or her solicitation activities. In this regard, an employee of an SEC-registered adviser who engages in solicitation activities on such adviser – just like a non-employee solicitor – may, depending on the facts and circumstances, be a person providing advice as to the selection or retention of an investment adviser and, accordingly, may be “investment adviser” within the meaning of Section 202(a)(11) of the Advisers Act who is subject to registration as such under the Advisers Act. But, in accordance with the SEC’s long-standing position, an employee of an SEC-registered adviser whose activities are under the control and supervision of such adviser is considered an “associated person” of such adviser who effectively rides the coat-tails of such adviser’s SEC registration and is not required to register as an investment adviser in his or her own right.<sup>1</sup> It is also the SEC’s long-standing position that an

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<sup>1</sup>See, e.g., [Corinne E. Wood](#) (pub. avail. April 17, 1986) (“*Corinne Wood Letter*”) (“... a person who is controlled by a Registrant would be a ‘person associated with an investment adviser’ within the meaning of Section 202(a)(17) of the Act and would have no obligation to register independently [as] an investment adviser (hereinafter referred to as ‘Associated Person’) [citing *The Burney Company* (pub. avail. Feb. 7, 1977) and *George A. Grossman* (pub. avail. Jan. 22, 1976)]. An Associated Person would be considered under the control of a Registrant if it performs investment advisory services on behalf of, and under the supervision or oversight of, the Registrant [citing *id.*]. See also, Investment Advisers Act Release No. 1601 at n. 65 and accompanying text

“independent contractor” whose activities are under the control and supervision of an SEC-registered investment adviser is considered an “associated person” of such adviser who is equally entitled to ride the same coat-tails.<sup>2</sup>

In light of the foregoing, in the absence of evidence demonstrating that non-employee solicitor arrangements are subject to abuses to which employee solicitor arrangements are not, an SEC-registered adviser should be entitled to treat a non-employee solicitor as an “associated person” -- just as it is entitled to treat an employee solicitor as an “associated person” -- as long, of course, as the adviser exercises control and supervision over such solicitor in connection with the performance of its solicitation activities. To conclude otherwise is to potentially reduce the number of solicitors available to SEC-registered advisers in a manner that does not advance any valid regulatory purpose.<sup>3</sup>

In conclusion, instead of withdrawing the 1979 Position, the SEC should reaffirm it.

Regardless of whether the SEC withdraws the 1979 Position, it should provide guidance regarding the circumstances under which it believes that “[s]ome solicitors may not be acting as investment advisers under the Act as a result of their solicitation activities.” Proposing Release at p. 202.

### **Comment Number 2:**

***The Commission should not mandate that the required written agreement between an SEC-registered adviser and a compensated solicitor designate the adviser (to the exclusion of the solicitor) or the solicitor (to the exclusion of the adviser) to be the party responsible for providing to a client the disclosure required to be delivered to a client pursuant to paragraph (a)(1)(iii) of the Proposed Revised Solicitation Rule<sup>4</sup> (“Required Disclosure”). Instead, the adviser and the solicitor should be free to agree that, in***

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(December 20, 1996) (“Persons who perform investment advisory services on behalf of, and under the supervision and control of a registered adviser are not required to separately register as investment advisers. See, e.g., Abid Mansoor (pub. avail. Feb. 5, 1992); Corinne E. Wood (pub. avail. Apr. 17, 1986); The Burney Company (pub. avail. Feb. 7, 1977).”

<sup>2</sup>See the *Corinne Wood Letter* (“Moreover, we have interpreted the term employee, and thus, an Associated Person, to include those independent contractors whose activities are controlled by the Registrant” [citing Investment Advisers Act Release No. 1000 (December 3, 1985) (a question and answer release relating to Form ADV), Robert S. Strevell (pub. avail. Apr. 29, 1985) and Institute of Certified Financial Planners (pub. avail. Jan. 21, 1986)]. <sup>2</sup> See also, the definition of “employee” contained in the Glossary to SEC Form ADV.

<sup>3</sup>Solicitors who are currently find the costs and burdens of regulation under the Advisers Act to be manageable because they are able to subject themselves to the control and supervision of SEC-registered investment advisers in lieu of registering as investment advisers in their own right might determine that the costs and burdens of such registration outweigh the benefits of serving as solicitors.

<sup>4</sup>Paragraph (a)(1)(iii) of the Proposed Revised Solicitation Rule provide that an SEC-registered adviser may compensate a solicitor only if such compensation is paid or provided pursuant to a written agreement with the solicitor that, among other things, designates the solicitor or the adviser to provide the client, at the time of any solicitation activities (or in the case of a mass communication, as soon as reasonably practicable thereafter) with a separate disclosure that states the following: (i) the adviser’s name; (ii) the solicitor’s name; (iii) a description of the adviser’s relationship with the solicitor; (iv) the terms of any compensation arrangement, including a description of the compensation provided or to be provided to the solicitor; (v) a description of any potential material conflicts of interest on the part of the solicitor resulting from the adviser’s relationship with

*some cases, the adviser shall be responsible for delivering (or permitted to deliver) the Required Disclosure to clients, and that in other cases the solicitor shall be responsible for delivering (or permitted to deliver) the Required Disclosure to clients. The focus of the requirement to deliver the Required Disclosure should be on ensuring that it gets delivered to a client in a timely manner (discussed below), not on mandating that one particular party shall have the exclusive responsibility to deliver it.*

Paragraph (a)(1)(iii) of the Proposed Revised Solicitation Rule provides that the required written agreement between an SEC-registered adviser and a compensated solicitor must designate the adviser or the solicitor as the party responsible for providing to the client, at the time of any solicitation activities (or in the case of a mass communication, as soon as reasonably practicable thereafter) with the Required Disclosure. The Proposed Revised Solicitation Rule thus implicitly acknowledges that, as long as the Required Disclosure is timely provided to a client, it should make no difference whether the adviser or the solicitor provides it. Since that is the case, it seems needlessly restrictive to require the adviser and the solicitor to select, as between themselves, the party who shall be exclusively responsible for delivering the Required Disclosure. As long as the adviser and the solicitor agree to an appropriate mechanism for ensuring that the Required Disclosure is provided to a client in a timely manner, they should have the flexibility to agree that either of them shall be required (or permitted) to deliver the Required Disclosure in particular cases or under particular circumstances. For example, an agreement might provide that the solicitor should provide the Required Disclosure to a client, but that if it fails to do so, the solicitor is obligated to notify the adviser, so that the adviser may provide it to the client.

### **Comment Number 3:**

*The Commission should provide greater flexibility regarding the time at which the Required Disclosure must be delivered to a client. It should not be necessary to deliver the Required Disclosure “at the time of the solicitation activities” (an undefined term that is vague). Instead, like other important disclosures of conflicts of interest (such as conflicts of interest required or permitted to be disclosed in Part 2A of an SEC-registered adviser’s SEC Form ADV), the Required Disclosure should be required to be delivered to a client before or at the time the adviser enters into an advisory agreement with the client (or accepts an investment in a private fund from a private fund investor, as applicable).*

Instruction 2 for Part 2A of SEC Form ADV (entitled “When must we deliver a brochure to clients?”) provides that an SEC-registered adviser “must give a firm brochure to each client before or at the time you enter into an advisory agreement with that client. See SEC rule 204-3(b) and similar state rules.”

General Instruction 3 for Part 2 of SEC Form ADV (entitled “Disclosure Obligations as a Fiduciary”) provides that “[u]nder federal and state law, you are a fiduciary and must make full disclosure to your clients of all material facts relating to the advisory relationship. As a fiduciary, you also must seek to avoid conflicts of interest with your clients, and, at a minimum, make full disclosure of all material conflicts of interest between you and your clients that could affect the advisory relationship. This obligation requires that you provide the client with sufficiently specific facts so that the client is able to understand the conflicts

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the solicitor and/or the compensation arrangement; and (vi) the amount of any additional cost to the client as a result of solicitation.

of interest you have and the business practices in which you engage, and can give informed consent to such conflicts or practices or reject them. To satisfy this obligation, you therefore may have to disclose to clients information not specifically required by Part 2 of Form ADV or in more detail than the brochure items might otherwise require. *You may disclose this additional information to clients in your brochure or by some other means.*” [emphasis added]

It is difficult to see how the conflict of interest disclosure component of the Required Disclosure can be said to be more important to a client than disclosure of other types of material conflicts of interest that an adviser must disclose to clients, either in its Part 2A brochure or otherwise. (Indeed, one can readily surmise that a client might take a greater interest in other types of conflicts of interest.<sup>5</sup>) It is therefore difficult to see why the conflict of interest disclosure in respect of solicitation arrangements must be provided to the client: (i) in a separate document and (ii) at a time different from the time at which an SEC-registered adviser is required to deliver its Part 2A brochure to such client.

In the absence of providing a reasoned and reasonable justification for concluding that, as a general matter, the conflict of interest disclosure component of the Required Disclosure is more important to clients than disclosure of other types of material conflicts of interest, the Required Disclosure should be required to be delivered to a client before or at the time the adviser enters into an advisory agreement with the client (or accepts an investment in a private fund from a private fund investor, as applicable), and an adviser should be free to include the Required Disclosure in its Part 2A brochure rather than in a separate document.

Further, while the Proposed Revised Solicitation Rule recognizes the impracticality of delivering the Required Disclosure “at the time of the solicitation activities” where the solicitation is made by way of a “mass communication,”<sup>6</sup> there may be other situations where it is not practical to deliver the Required Disclosure “at the time of the solicitation activities.” Suppose, for example, that a solicitor participates in a business function or social gathering (or is even sitting on an airplane) and meets individuals who the solicitor believes may be interested in learning about the adviser’s services. Even assuming that the solicitor possesses a written copy of the Required Disclosure (or a script of the Required Disclosure, if it is to be delivered orally), it may simply be inappropriate for the solicitor to deliver the Required Disclosure to the client under the circumstances. That, however, should not stop the solicitor from making a “short hand” introduction of the adviser, to be followed, at an appropriate time, by the Required Disclosure.

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<sup>5</sup>See, e.g., the conflict of interest disclosures required by Items 5.E, 6, 10.C, 10.D, 11.B, 11.C, 11.D, 12.A.1, 12.A.2, 12.A.3, 14.A and 17.A of Part 2A of SEC Form ADV (and Items 4.A of Part 2B of SEC Form ADV), each of which is arguably of equal if not greater importance to clients than conflict disclosure relating to solicitation arrangements.

<sup>6</sup>See the Proposing Release at pp. 222-3 (“...we are proposing a modification to the timing of the delivery of the solicitor disclosure for solicitations that are conducted through mass communications. Mass communications include communications that appear to be personalized to a single investor (and nominally addressed to only one person), but are actually widely disseminated to multiple investors, as well as impersonal outreach to large numbers of persons... In these cases, we are proposing to permit the solicitor disclosure to be delivered at the time of solicitation or as soon as reasonably practicable thereafter, because it may not be practicable to deliver the solicitor disclosure at the time of initial solicitation... Under the proposed rule, we would view delivery of the solicitor disclosure to be made as soon as reasonably practicable after the time of a mass solicitation if it is provided promptly after the investor expresses an initial interest in the adviser’s services... If the adviser, rather than the solicitor, has agreed to deliver the disclosure, we would view ‘as soon as reasonably practicable thereafter’ as being at the time the investor first reaches out in any manner to the adviser in response to the solicitation.”)

As discussed above, the “appropriate time” for delivery of the Required Disclosure is before or at the time the adviser enters into an investment advisory agreement with the client (or accepts an investment in a private fund from a private fund investor, as applicable). If the Commission believes that the “appropriate time” is earlier than that, it should nevertheless make allowance for the potential impracticality of delivering the Required Disclosure “at the time of the solicitation activities,” perhaps by simply requiring that the Required Disclosure be provided to a client no later than a specified period of time (such as 24 hours) prior to the time the client enters into an advisory agreement with the adviser.

#### **Comment Number 4:**

***The Commission should clarify that, under the circumstances discussed below, a party that sells a list containing the names and contact information of potential prospects to an SEC-registered adviser, or that otherwise provides the names and contact information of potential prospects to an SEC-registered adviser for compensation, should not be considered a “solicitor” within the meaning of paragraph (c)(4) of the Proposed Revised Solicitation Rule solely as a result of engaging in such activities, as long as neither such seller nor such SEC-registered adviser indicates to any such prospect the identity of such seller.***

The Proposing Release (at pp. 15-16) articulates the underlying purpose of the Solicitation Rule as follows:

“The person or entity compensated, commonly called the ‘solicitor,’ has a financial incentive to recommend the adviser to the investor. Without appropriate disclosure, this compensation creates a risk that the investor would mistakenly view the solicitor’s recommendation as being an unbiased opinion about the adviser’s ability to manage the investor’s assets and would rely on that recommendation more than he or she otherwise would if the investor knew of the incentive.”<sup>7</sup>

In light of the underlying purpose of the Solicitation Rule, the SEC should clarify that a party that sells a list containing the names and contact information of potential prospects to an SEC-registered adviser, or that otherwise provides the names and contact information of potential prospects to an SEC-registered adviser for compensation, should not be considered a “solicitor” within the meaning of paragraph (c)(4) of the Proposed Revised Solicitation Rule solely as a result of engaging in such activities, as long as neither

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<sup>7</sup>See also the Proposing Release at p. 215 (“We are proposing to permit either the adviser or the solicitor to deliver the solicitor disclosure, rather than requiring the solicitor to deliver the disclosure, provided that the written agreement designates the party responsible for its delivery. We believe that this provision would continue to promote investor protection, while providing firms with greater flexibility in meeting the rule’s requirements. *It would place the fact of the solicitor’s interest in front of the investor at the time the investor is solicited so that the investor is provided the necessary tools to evaluate any potential bias on the part of the solicitor.*” [emphasis added]); Proposing Release at pp. 215-6 (“The proposed rule would require the solicitor disclosure to include the investment adviser’s name, the solicitor’s name, and a description of the investment adviser’s relationship with the solicitor... The current rule requires similar disclosures... We are proposing these requirements because they provide important information and context to investors... The name of the solicitor is important so the investor can seek to assess the reputation or other qualifications of the solicitor. Disclosure of the relationship between the adviser and the solicitor is important to give the investor context— that — when combined with the other proposed disclosures about the compensated nature of the solicitation — *would inform investors about the solicitor’s bias in referring the adviser.*” [emphasis added]).

such seller nor such SEC-registered adviser indicates to any such prospect the identity of such seller.<sup>8</sup> Under these circumstances, it cannot be said that a prospect could be misled in any way as a result of such activities, for the simple reason that, in these circumstances, the prospect, by definition, is not relying on any recommendation, explicit or implicit, from such seller to retain the services of such adviser and cannot possibly be subject to any bias on the part of such seller.<sup>9</sup> Accordingly, the purpose underlying the Proposed Revised Solicitation Rule argues against the conclusion that such activities are the type of “solicitation” activities that are appropriately governed by the Proposed Revised Solicitation Rule.

If the Commission believes that such activities are the type of “solicitation” activities that are appropriately governed by the Proposed Revised Solicitation Rule, it should clarify how the rule would apply to such activities. For example, when would a “solicitation” be deemed to be made in such circumstances, triggering the obligation to deliver the required disclosure? Surely, the solicitation should not be deemed to be made at the time the seller sells the list, since at that point persons on the list would have absolutely no idea why such disclosure is being provided to them and, indeed, the adviser may determine not to contact some persons whose name are on the list. (See also note 9, *supra*.)

**Comment Number 5:**

***The Commission should clarify that if, under the Proposed Revised Solicitation Rule, an SEC-registered adviser or solicitor delivers the Required Disclosure orally instead of in writing,<sup>10</sup> such Required Disclosure in oral form needs to be recorded prior to being provided to a client, not at the time it is actually provided to a client.***

The Proposing Release states (at p. 214) that “...under the proposed rule the solicitor disclosure could not be delivered orally unless the oral disclosure is recorded and retained.”

The Commission should clarify that this means that, where an SEC-registered adviser or its solicitor elects to deliver the Required Disclosure orally, it must:

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<sup>8</sup>That fact that such a seller would not be considered a “solicitor” for purposes of the Solicitation Rule would not relieve such seller of the obligation to provide the names and contact information of potential prospects to an SEC-registered adviser in a manner consistent with applicable law (including applicable privacy laws) and with any fiduciary or similar duties that such seller may owe to such prospects.

<sup>9</sup>If a client whose name and contact information have been provided to it by such a seller bears any cost in connection with retaining the adviser that it would not have borne in the absence of the adviser’s compensation of such seller, the adviser would need to consider whether it has a fiduciary obligation to disclose that fact to such client. Further, if a client requests the adviser to reveal the identity of such seller and the adviser honors that request, it is arguable that such seller should be viewed as having made a solicitation for purposes of the Proposed Revised Solicitation Rule at the time such adviser reveals such seller’s identity to such client.

<sup>10</sup>At page 213 of the Proposing Release, the Commission states that it is proposing to remove the current requirement of the Cash Solicitation Rule that the disclosure required to be provided to a client be “written.”

- prepare and record a “template” of the Required Disclosure in oral form prior to the time it orally provides such Required Disclosure to a client, not at the time it actually provides such Required Disclosure to a client; and
- materially adhere to such “template” whenever it provides the Required Disclosure in oral form to a client.

In short, the Commission should clarify that oral disclosure need not be recorded and retained each and every time it is made as long as it complies with the requirements set forth in the immediately preceding two bullet points.

**Comment Number 6:**

*The Commission should clarify:*

- *the circumstances under which materials utilized by a “solicitor” (as defined in paragraph (c)(4) of the Proposed Revised Solicitation Rule) would be considered “advertisements” that are “by or on behalf of” an investment adviser within the meaning of proposed Rule 206(4)-1(e)(1) under the Advisers Act; and*
- *if such materials are considered “advertisements” within the meaning of proposed Rule 206(4)-1(e)(1) under the Advisers Act, the circumstances under which such advertisements would be deemed to include “endorsements” by a solicitor within the meaning of proposed Rule 206(4)-1(e)(2).*

At page 26 of the Proposing Release, the Commission states that “[w]e believe third-party content is ‘by or on behalf of’ an adviser when the adviser takes affirmative steps with respect to the third-party content. For example, third-party content could be by or on behalf of the investment adviser if the investment adviser: (i) drafts, submits, or is otherwise involved substantively in the preparation of the content; (ii) exercises its ability to influence or control the content, including editing, suppressing, organizing, or prioritizing the presentation of the content; or (iii) pays for the content.”

Is this the test the Commission would apply to materials prepared by solicitors? Does the fact that an adviser pays a solicitor for its solicitation activities mean that the adviser will be deemed to have “paid for the content” of any materials prepared by a solicitor, such that all materials prepared by a solicitor in relation to a particular adviser will be deemed to be “advertisements” of that adviser? In light of the nature of solicitation activities, would all materials produced by a solicitor in relation to a particular adviser be considered an “endorsement” of the adviser by the solicitor?

Again, I thank you for the opportunity to comment.

x/Joseph H. Nesler/  
Joseph H. Nesler